

REPORT PREPARED FOR

**Dorset County Pension Fund**

**Meeting of the Pension Fund  
Committee on 26<sup>th</sup> June 2014**

**Governance Compliance Update**

**12<sup>th</sup> June 2014**

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## Introduction

This is my sixth 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 June 2013 and those currently under review.

Since my last report consultation and discussion documents have been issued by the DCLG on the two pivotal issues of governance and pension fund re-structuring. While a consultation is currently in progress on the latter, we still await, at the time of writing, a formal consultation on proposed new governance arrangements, although this is promised imminently. I refer to both these issues in more detail below and these represent the major issues on which I shall report this year.

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

- ✓ I have reviewed the business and minutes of Committee meetings since June 2013 and I am satisfied that governance standards are being maintained and improved.
- ✓ There remain some minor updating issues on the published statements.
- ✓ There have been no regulatory changes affecting the governance arrangements.
- ✓ The implications of the Public Sector Pensions Act 2013 were considered last year and consultation on proposed changes by DCLG is awaited still.
- ✓ The DCLG's proposals on opportunities for collaboration, cost savings and efficiencies are currently under consultation, giving continuing uncertainty on future investment management arrangements.

## Recommendations

- [1] That the Governance Compliance Statement is updated with immediate effect in relation to Principles E, F and G.
- [2] That the current Myners Compliance Statement is updated with immediate effect.
- [3] That developments on proposed new regulations on governance and on the Government's proposals on opportunities for collaboration, cost savings and efficiencies, including investment regulations, are closely monitored.

## Core business activity

A review of the Committee's core business activity at meetings since June 2013 confirms that governance standards continue to be maintained and improved where necessary. While I refer below to some minor updates required to the published statements this does not impact on the Committee's continuing high standards of governance in transacting business.

I note in particular a satisfactory audit report on the Fund's accounts and controls, and the approval of a Pensions Administration Strategy in November. The actuary's triennial report has been considered and the implications addressed, and the Committee maintains a robust approach to strategic investment issues and the monitoring of investment activity and performance.

## Compliance statements and website

### **Governance Compliance Statement**

In my report last year I referred to some minor updating to the Statement as posted on the website, viz:

- 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.

I also recommended that the more detailed responsibilities agreed in June 2012 be included in the description of the Pension Fund Committee in the "Council and democracy" section of the main website at a suitable opportunity.

### **Myners Compliance Statement**

Last year I recommended 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.

I note however that the version on the website, dated September 2010, contains a number of highlighted areas where changes have since been agreed and the Statement should be updated.

### **Website documentation**

While these changes represent only a tidying up of the documentation and do not affect the Committee's operations, they do impact on public perception of current policies. Work is currently underway by the Shadow Scheme Advisory Board to collate annual reports in response to the Government's concerns on the lack of available data and information. It is not inconceivable that at some future stage this might lead to some form of national review of published statements as required by the regulations, either by the Board or by the Pensions Regulator when that body takes on governance oversight in 2015.

## New regulations on governance

In my report last year I set out 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. Much of what I said then was dependent on further papers issued by DCLG.

A discussion paper was issued by DCLG on 20<sup>th</sup> June 2013 for response by 30<sup>th</sup> August and the Committee were informed at their September meeting that the officers had responded. I am not aware if the Committee has seen the full content of the discussion paper or the response.

I provided the officers with a commentary on the issues raised by DCLG on 2<sup>nd</sup> August and as much of the content relates to the future governance of the Dorset Pension Fund, I have attached a copy of my paper as **Appendix A**.

Most of what I said then was supposition in the expectation that a full consultation would be issued by the end of the calendar year and in the hope that regulations could come into force by 31<sup>st</sup> March 2014. That has proved not to be the case and a consultation document is still awaited, though said to be imminent. Should the document be issued prior to the Committee's meeting on 26<sup>th</sup> June, I will either provide an addendum to this report or comment orally at the meeting.

I should add that the Pensions Regulator, who will become responsible for guidance on governance from 1<sup>st</sup> April 2015, has issued a discussion paper and draft guidance but as these necessarily await concrete proposals from DCLG, I have not commented on their papers at this time.

It is particularly unfortunate that proposals to enhance governance arrangements have been delayed for so long and will restrict the time available to implement any new regulations, itself a major distraction to 'good governance'. Furthermore, the situation has led to supposition and informal comments by DCLG in the public domain.

For example, DCLG have indicated informally that the pension board will be separate from the statutory committee, but in the absence of any substantive proposals, it is difficult to advise the Committee on any action that can be taken.

## Future structure of the LGPS

In my report last year, I referred to a recent announcement by the Minister for a 'call for evidence' on the future structure of the LGPS. In **Appendix B**, I have set out a brief summary of the timeline of events since last June. It is important to note in governance terms, the extended timescale over which the Government's proposals have been formulated against the limited time available for consideration and response by interested parties.

Notwithstanding such concerns, consideration should now be focussed on the consultation issued by DCLG on 1<sup>st</sup> May for response by 11<sup>th</sup> July. A large part of the proposals now under consideration relate to the investment of pension fund assets and their management. I have not sought to address investment implications in this paper but to set the scene for the Committee and comment on governance issues that may arise.

The consultation paper describes the DCLG's "*package of proposals*" in the following terms:

- *Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs.*
- *Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market.*
- *Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme.*
- *A proposal not to pursue fund mergers at this time.*

While not part of the proposals, the paper also states that "*the Government has decided not to consult on administration reform at this time. However, the call for evidence has highlighted the scope for potential administrative efficiencies as well as the associated risks. At this stage, the Government proposes to allow the administration arrangements for the 2014 Scheme to mature before considering reform any further*".

DCLG have provided an introduction and background to the process and the case for change, summarising the proposals and objectives. They make two core proposals:

**Proposal 1:** Common investment vehicles;

**Proposal 2:** Passive fund management of listed assets;

and pose five questions for responses. I have listed these questions in **Appendix C** with brief commentary on key issues from a governance perspective.

The Government is seeking respondents' views on the proposals and asks respondents to consider how if adopted these reforms might be implemented most effectively, providing an explanation of and evidence for those views.

Peter Scales  
12<sup>th</sup> June 2014

REPORT PREPARED FOR

**Dorset County Pension Fund**

**Local Government Pension Scheme  
Discussion paper on new governance  
arrangements**

**Commentary on the issues raised  
and questions posed**

**2<sup>nd</sup> August 2013**

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## Introduction

The discussion paper on new governance arrangements for the LGPS was published by DCLG on 20<sup>th</sup> June 2013. The deadline for responses is **30<sup>th</sup> August 2013**.

The paper addresses the key provisions of the Public Service Pensions Act 2013 and how new arrangements will apply to the LGPS with effect from 1<sup>st</sup> April 2014, and explores five specific sections. I comment on these sections, the implications for Dorset, and make suggestions for responses.

## Timing

I have said previously that DCLG were indicating that new regulations on governance would not be available for some time - this paper seems to confirm that. While I am sceptical that the regulations will be made and laid by April 2014, it would make sense to allow a reasonable time for the new arrangements to be established.

For those funds that need to, this will allow time for finding and appointing new representative members to local boards, and for all the delegation and reporting arrangements to be put in place.

***Q1. What period, after new governance regulations are on the statute book, should be given for scheme managers/administering authorities to set up and implement local pension boards?***

I would suggest twelve months from the date new regulations come into force. Formal reporting under the regulations apply to the annual report for the following year, i.e. if new regulations come into force in April 2014, the annual reporting requirements would commence with 2015-16. However, see comment below under Part 1 regarding the Pensions Regulator.

***Q2. How long after new governance regulations are on the statute book should the national scheme advisory board become operational?***

On the basis of Q1 and that a shadow board is being established, I would suggest it should become operational from 1<sup>st</sup> April 2014 to allow new guidance to be prepared and issued. However, guidance should be available as soon as possible after that date so as not to eat too far into the twelve month preparatory period under Q1.

## Part 1 - "Responsible authority"

This is as anticipated, my only concern being the relationship between the Secretary of State and the Pensions Regulator, who, it is stated, will not commence any of their formal duties or responsibilities under the Act until April 2015.

## Part 2 - "Scheme manager"

As reported previously, this will be the administering authority and will also be responsible for administering any connected scheme, excluding injury or compensation schemes.

**Q3. Please give details of any such “connected” scheme that you are aware of.**

**Q4. Are there any schemes connected to the main Local Government Pension Scheme, other than an injury or compensation scheme, that the new Scheme regulations will need to refer to in setting out the responsibilities of scheme managers?**

I am not aware of any connected schemes for Dorset.

### **Part 3 - “Pension board”**

This section clarifies, to some extent, the role of the Pension Board (PB), or at least, what the Scheme regulations will need to include. However the questions are somewhat circular in that the fundamental issue is whether the pension board is separate from a statutory committee and that affects a number of the other questions. I will deal with them as they appear in the paper.

The responsibilities of the PB are set out in paragraph 1.16 in summary form but are better expressed in the section under implementation - paragraph 1.22. The paper also refers to what the regulations “must have regard to” or “will need to”, which include:

- The desirability of securing the effective and efficient governance of the scheme;
- The requirement for the scheme manager to be satisfied that PB appointees do not have a conflict of interest;
- Ensure each PB includes employer representatives and member representatives.

As regards the last bullet, it is interesting to note that “member representatives” are defined as permitting nominations from trade unions or from members who are not members of trade unions. This implies that member representatives can be trade union representatives but who are not members of the scheme, and/or that those who are members of a trade union can only be put forward by that trade union. This might be a point worth clarifying.

### **Implementation**

The paper defines the role of each Pension Board more fully as:

*“The role of each pension board is to assist the scheme manager/administering authority in securing compliance with scheme regulations and other legislation; with Pension Regulator’s codes of practice and with any other matters specified in Scheme regulations.”*

and poses the question:

**Q5. What “other matters”, if any, should we include in Scheme regulations to add to the role of local pension boards?**

I would hesitate to suggest any further regulatory requirements but it could be worth highlighting the fiduciary role of the PB to scheme members and other stakeholders.

Interestingly, this definition introduces the future role of the Pensions Regulator in issuing codes of practice (though not until after April 2015). This may or may not preclude the current references to CIPFA codes of practice.



The second point is *“a requirement for scheme managers/administering authorities to check that no person appointed to the board has any conflict of interest as defined in the Act and also to undertake regular checks”*.

The definition of “conflict of interest” is defined in Section 5(5) of the Public Sector Pensions Act and is reiterated in paragraph 1.18 of the paper as *“as any financial or other interest which is likely to prejudice the person’s exercise of functions as a member of the board, but does not include a financial or other interest arising merely by virtue of being a member of the Scheme”*, and poses the question:

***Q6. Should Scheme regulations make it clear that nobody with a conflict of interest, as defined, may be appointed to or sit on a pension board?***

It would seem to me that it would be helpful to have this definition enshrined in the regulations and it will be necessary to ensure that these requirements are clearly identified for potential members of the PB, and regularly monitored as is the case currently.

This leads to the suggestion in the paper of *“a provision requiring a member of the board or person proposed to be a board member to provide whatever information about conflict of interest that the scheme manager/administering authority reasonably requires”*, and poses the question:

***Q7. Should Scheme regulations prescribe the type of information that may be “reasonably required”?***

Since this is an area where confusion can arise on exactly what is covered, I would agree that prescription in the regulations would be helpful to the scheme manager.

As regards *“a requirement that each pension board must include employer representatives and member representatives in equal numbers”*, the question is posed:

***Q8. Although not required by the Act, should Scheme regulations prescribe a minimum number of employer and employee representatives?***

As happens now, the availability of individuals to act as employer or member representatives will vary across funds and I do not think a minimum number should be prescribed. Some funds have experienced problems finding willing nominations.

### **Can a statutory committee also be the local pension board?**

The paper addresses the fundamental issue of where the PB should sit in the governance structure. The paper confirms that a committee of the administering authority can also act as the PB and sets down some key factors, viz:

- The additional costs of having a separate committee and PB
- A single committee would be in no position to fulfil the clear scrutiny role, i.e. it cannot scrutinise itself
- The combined body must have equal numbers of employer and member representatives
- Whatever the outcome of consultation, the final decision will apply consistently across the Scheme

The paper suggests that if two separate bodies are required, funds would be encouraged to use existing non-statutory bodies to take on or adapt to the new role of PB, bearing in mind the need for equality of representation. The question posed is therefore:

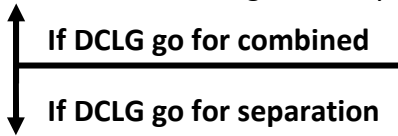
***Q9. Should the new Scheme regulations require local pension boards to be a body separate from the statutory committee or for it to be combined as a single body?***

Reading between the lines and based on previous indications, there appears to be a leaning towards having a separate “scheme management committee” (my words) and a Pension Board. This would raise a number of issues based on current arrangements and those now proposed.

For example, no mention is made of statutory responsibility and accountability which currently rests with the primary committee, or of voting rights. Would a separate statutory committee have the same regulatory requirements for conflicts of interest, representation, and levels of knowledge and skills. This last point seems likely to be covered by a tPR code of practice, but would the code be applied to a separate statutory committee?

This is far from clear and it seems likely that responses to the consultation will lay out a range of different solutions. It might almost be presumed that new governance arrangements will return to the ‘old’ model of the administering authority having a standard committee of elected members from that authority, and a separate Pension Board to which will be applied all the new governance arrangements. Such an outcome would undo much of the worthwhile improvements to governance arrangements over the past 5 to 10 years.

I suggest four options might be considered:

- [1] Fully combined**  
Statutory Committee and Pension Board are one with equal representation and all members given voting rights
  - [2] Limited combined**  
Statutory Committee and Pension Board are one with equal representation but only elected members are given voting rights. This could be varied to restrict voting rights to administering authority elected members.
- 
- [3] Hybrid Committee/Board**  
The Statutory Committee and the Pension Board are separate but meet at the same time - question on voting rights. PB can also meet separately for scrutiny review purposes. Employer and member representatives report back to annual meetings.
  - [4] Total separation**  
The Statutory Committee and the Pension Board are completely separate, with reporting arrangements between the two.

There are a number of variations of these options but these four help identify the sticking points. Voting rights will be one of those sticking points and it seems likely that regulations will require equality of voting rights as well as representation.

As far as Dorset is concerned, the options are complicated by the current arrangements and the particular members acting as chairman and vice-chairman. I've tried to translate the Dorset position into the options listed above and conclude as follows:

<b>Current position</b>	Administering authority	<b>5</b>	
	Employer representatives	<b>3</b>	(incl. Chm and Vice-Chm)
	Scheme member representative	<b>1</b>	(union nomination)
	<b>Total (all voting)</b>	<b>9</b>	(quorum = 3)

**Option 1** - This would be consistent with the current arrangements of a single committee. However, to meet the equality requirements, either:

**[A]**      **2** further scheme member representatives would need to be appointed but this takes the majority vote away from the administering authority and increases membership to **11**.

Or

**[B]**      Remove **1** Unitary authority representative and add **1** pensioner representative. This achieves equality and keeps total membership to **9**, but loses either the current chairman or vice-chairman which might not be a good move at a time of change

**Option 2** - This option doesn't really work for Dorset as the two key voting members are the chairman and vice-chairman. However, Option 1[A] could work if the scheme member representatives do not have a vote - hard on Johnny Stephens - in order to maintain an administering authority majority.

If DCLG go for the single committee option, then the best solution might be to use my option **1[B]** and plan to find another suitable chairman or vice-chairmen from the County Council members, or to adjust the voting entitlement.

**Option 3** - This could work for Dorset with 4 members forming the Pension Board. The Scheme Management Committee would consist of County Council members only and the PB members would attend each meeting but with no vote. The PB could meet separately in advance of the annual employer meeting (question of whether there should be an annual scheme member meeting) or at other times if they wish. In this way they would hear the same reports and advice as the main committee. They could even stay on after the committee finishes to discuss any issues that have arisen, and officers/advisers could stay on if required.

**Option 4** - This could work for Dorset if the current committee continues as the Scheme Management Committee and the separate Pension Board is formed from the existing employer representatives and scheme member representative plus two more. This would give a PB of 6 members but as two would be the Chairman and Vice-chairman, and 4 will have attended the main committee, there should be less need for additional advice, although an officer would need to attend.

None of these options are perfect and all depend on the decision about combined or separate, and whether any regulation is made about voting rights, and additional administrative functions. **However, one thing is certain; the existing arrangements will not be able to continue.**

## Level of prescription

In my view, we should aim for the least prescription possible. The questions posed are:

***Q10. Apart from what is required under the Act, what other elements of local pension boards should be set out in the new Scheme regulations?***

***Q11. Apart from what is required under the Act, what other elements of local pension boards should be left to local determination?***

I would suggest a response therefore that as much as possible should be left to local determination in line with guidance issued, as is the case currently. You are asked to comment on how the nomination process should operate and apart from setting down a process of selection from nominations made by each representative group, there is nothing much to add.

## Restrictions on membership

***Q12. Should the new Scheme regulations prevent any incumbent scheme member representative being moved from a statutory committee to the local pension board (if the committee and the board are not one and the same body)?***

The inference here is the PB might be considered a lesser body if separated from the Statutory Committee and also underlies the question of voting rights. However, the overriding factor may well be that there are insufficient member representatives willing to be appointed. Also, in a separated structure, existing representatives could add significant knowledge and expertise to the new PB. My simple response to the question would therefore be “no”.

## Annual report

I would not disagree with a separate PB preparing a brief report on its activities although this suggests a separate series of actions under the scrutiny role which are not likely to be onerous, or if they are, will require resourcing. Either way the requirement to report should be covered by guidance and not by regulation.

My response would therefore be “no” to the question:

***Q13. Should the new Scheme regulations include a requirement for each local pension board to publish an annual statement of its work and for this to be sent to the relevant scheme manager, all scheme employers, the scheme advisory board and Pensions Regulator?***

## Training and qualifications

***Q14. Apart from the training and qualification criteria that may be covered by the Pensions Regulator in a code of practice, are there any specific issues that we should aim to cover in the new Scheme regulations as well?***

In my view, any requirements relating to training and qualification should be kept to codes of practice and not regulation, so my response would be “none”.

## Part 4 - Pension board - information

Any regulatory requirement to publish information about the PB should be included in the regulations on the annual report.

## Part 5 - "Scheme advisory board"

This sections contains a series of questions about the establishment of the SAB but says little about how it will operate in practice. My suggested responses to each question are brief.

***Q15. Should Scheme regulations simply replicate the wording of the Act? If not, what specific areas of work should the new Scheme regulations prescribe?***

Yes to keep it as flexible as possible.

***Q16. Should Scheme regulations include a general provision enabling the scheme advisory board to advise the Secretary of State on the desirability of changes to the Scheme as and when deemed necessary?***

Yes in order for the SAB to be proactive to scheme managers and pension boards.

***Q17. Are there any specific areas of advice that Scheme regulations should prohibit the scheme advisory board from giving?***

The SAB should not be involved in investment matters, the selection and appoint of advisers and fund managers, except insofar as such involvement relates to guidance on good practice or interpretation of the regulations. Also the SAB should not be involved in any areas where there is a conflict of interest or on matters on which they do not the required knowledge and skills.

***Q18. What options (if any other, please describe) would be your preference for establishing membership of the scheme advisory board?***

I would suggest the membership profile of the shadow advisory board but with the rider of there being requirements, as for the Pension Board, regarding conflict of interest, and qualifications and skills.

***Q19. Should Scheme regulations require the Secretary of State to approve any recommendation made for the position of Chair?***

Yes - the Secretary of State should take responsibility for this oversight position.

***Q20. Should Scheme regulations prescribe tenure of office? If so, what should the maximum period of office be and should this also apply to the Chair of the board?***

I would suggest a three year term of office and only being able to stand for re-appointment on one occasion.

**Q21. Should Scheme regulations make provision for board members, including the Chair, to be removed in prescribed circumstances, for example, for failing to attend a minimum number of meetings per annum? If so, who should be responsible for removing members and in what circumstances (other than where a conflict of interest has arisen) should removal be sought?**

Yes as this should be a responsibility of the Secretary of State. Other circumstances would be failure to undertake their duties in accordance with regulatory requirement, abuse of position, acting illegally or without due regards to the objectives of the SAB.

**Q22. Should Scheme regulations prescribe a minimum number of meetings in each year? If so, how many?**

Yes, at least four.

**Q23. Should Scheme regulations prescribe the number of attendees for the board to be quorate? If so, how many or what percentage of the board's membership should be required to be in attendance?**

Yes, one-third of the membership.

**Q24. Rather than make specific provision in Scheme regulations, should the matters discussed at Q19 to Q23 be left as matters for the scheme advisory board itself to consider and determine?**

No, this is not the time for self-regulation. The SAB will need to be accountable for its actions and should be required to report annually on its activities to all scheme managers and pension boards.

**Q25. Should the scheme advisory board be funded by a voluntary subscription or mandatory levy on all Scheme pension fund authorities?**

A voluntary subscription does not make sense as no scheme manager can extract itself from the system and process. However, a levy must be subject to approval by scheme managers otherwise there will be no control on the SAB's costs or capacity to undertake all sorts of projects. The SAB should remain as a supervisory body and limit its costs to an essential minimum. It should also be fully accountable for what it spends.

**Q26. What would be your preferred manner of legal constitution of the scheme advisory board and how should Scheme regulations deal with the issue of personal liability protection for board members?**

I suggest the SAB should be an NDPB, i.e. a quango, and constituted in that form. The Government should indemnify all members of the SAB unless they act illegally or outside their terms of appointment.

Peter Scales  
2<sup>nd</sup> August 2013

## Call for evidence - timeline

<p><b>2013</b> <b>June</b></p>	<p>DCLG publish a 'call for evidence' on the future structure of the LGPS on 21<sup>st</sup> June for responses by 27<sup>th</sup> September.</p>
<p><b>August</b></p>	<p>I provide officers with a commentary on the proposals on 2<sup>nd</sup> August.</p>
<p><b>September</b></p>	<p>Consultation closes on 27<sup>th</sup> September.</p> <p>Dorset fund responds as reported to the Committee in November.</p> <p>Hymans Robertson are commissioned by the Government to provide cost-benefits analysis but without recommendations on three options:</p> <ul style="list-style-type: none"> <li>• Establishing one common investment vehicle for all funds</li> <li>• Creating five to ten common investment vehicles for fund assets</li> <li>• Merging the existing structure into five to ten funds</li> </ul>
<p><b>December</b></p>	<p>Hymans Robertson submit their report to Government but it is not published.</p>
<p><b>2014</b> <b>January</b></p>	<p>Shadow Advisory Board publish their analysis and recommendations on the call for evidence.</p>
<p><b>May</b></p>	<p>On 1<sup>st</sup> May, DCLG issue:</p> <ul style="list-style-type: none"> <li>• a response to the June 2013 consultation;</li> <li>• a consultation on their proposals; and</li> <li>• the Hymans Robertson report.</li> </ul> <p>The deadline for responses is 11<sup>th</sup> July.</p>

## Government's proposals on opportunities for collaboration, cost savings and efficiencies

### Proposal 1: Common investment vehicles

- Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.**
- Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?**
- Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?**

### Comments

In simplistic terms, it is difficult to disagree with Q1 in terms of economies of scale and fund management costs, particularly in the wake of the evidence produced by Hymans Robertson. The questions to raise would include:

- Would the transfer of responsibility for manager selection and monitoring to a CIV weaken governance, particularly at a time when pension boards are supposedly strengthening governance?
- Would flexibility in asset allocation decisions and tactical switching be hampered by a CIV operator?
- Would investment choice and/or management style be constrained?
- Would there be issues of conflict of interest?
- Would the CIV operator be regulated and required to have the appropriate level of skills and knowledge?
- Who would operate the CIV, and who would be accountable to whom and by what process?
- How transparent would the CIV be in terms of performance monitoring and transaction cost disclosure?
- How would the CIV operator account for currency management, stock lending, voting and engagement, and transition management, for example?

In governance terms, the Committee would want to retain control over asset allocation (Q2) as it would still be responsible for investment outcomes. Asset allocation is said to be the main driver of outperformance rather than active management, which underlies the Government's proposal for passive management and is evidenced in part by Hymans Robertson and WM.



As regards the number of CIVs (Q3), this is perhaps more of an investment issue and diversification will be a key point. It is not entirely clear if the question relates to geographical areas or asset classes. However, in governance terms, if the use of a CIV is supported by a properly regulated structure, then one would appear to suffice. Hymans Robertson report a slight improvement in costs savings by having a single CIV.

The question of how many asset classes would appear to hinge on the divergent aspirations for cost savings and a desire for flexibility of choice and/or replication of existing mandates. Of course, greater choice means more complexity and the need for more robust governance arrangements.

The paper also addresses the question of whether the investment regulations will need to be amended and states:

4.13 The Government recognises that the investment regulations are in need of review. The Department will consult separately on reforms to these regulations, including any changes required to facilitate investment in common investment vehicles. **However, any initial thoughts would be welcome in response to this consultation.**

I have suggested in previous reports that the investment regulations need to be reviewed and provide greater flexibility on a risk basis. The cynic in me suggests that, once again, the Government is prepared to consider a review of the investment regulations to allow its own proposals to work (e.g. infrastructure in 2013). Many of the restrictive elements in the current regulations arose from concerns by the Government Actuary in the '80s and '90s that local authorities were investing too much in pooled funds with single managers!

The final question in this proposal relates to the type of investment vehicle:

At this time, the Government would like to seek views on the specific type of common investment vehicle to be used, but anticipates that the following principles might underpin the design:

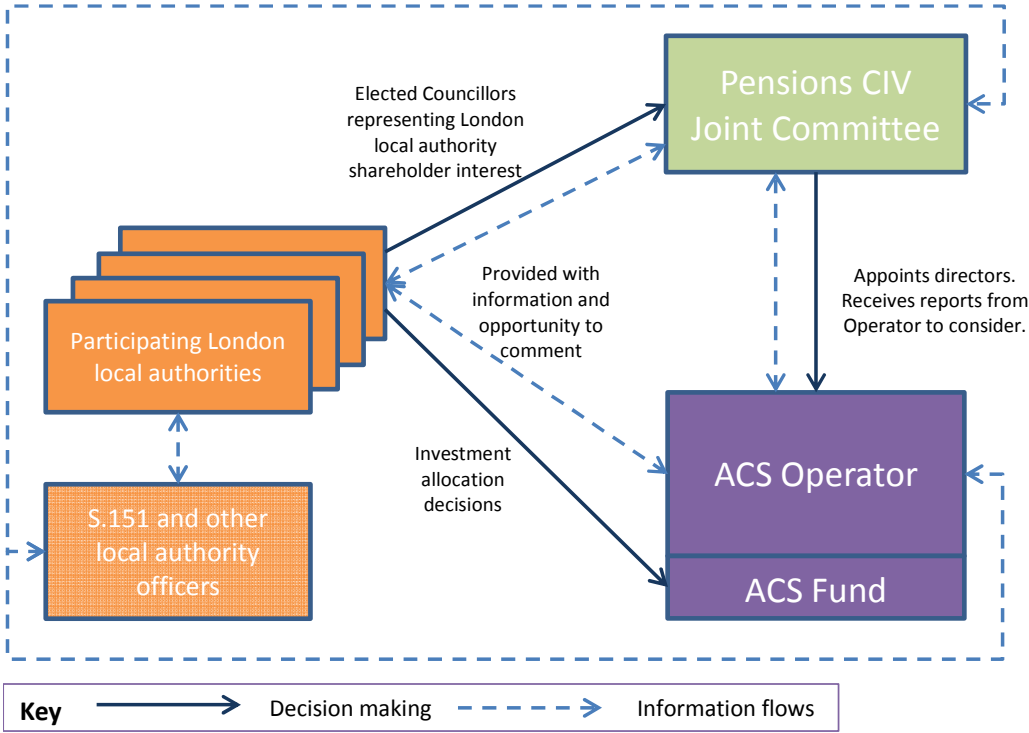
- Pooling of assets, possibly on a unitised or share basis;
- Safeguards for individual funds, for example through Financial Conduct Authority authorisation;
- Governance arrangements considered as part of wider governance reforms arising from 2013 Public Service Pensions Act;
- Strategic asset allocation remains with individual funds; and
- An option for other funded public service pension schemes to participate in the common investment vehicles if they wish.

4.15 There are a number of types of common investment vehicle available that might fulfil some or all of these principles. One such model currently under review is the tax transparent Authorised Contractual Scheme. However, careful consideration of the governance arrangements for any common investment vehicle would be needed before any more detailed proposals are developed.

**Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?**

It is difficult to comment on governance arrangements without knowing how the DCLG will consult on wider governance issues. I have already mentioned a number of governance issues above which will need to be considered but the fundamental issue will be whether the Scheme Manager (the statutory committee) and/or the pension board can continue to deliver its responsibilities in the same and in an improved manner with the use of a CIV.

It is worth noting the current arrangements being developed for the London CIV which is the most advanced (apart from that operated by States of Jersey) and who have chosen the route of an Authorised Contractual Scheme (ACS). The proposed structure is below:



The ACS Operator is a limited company established by London Councils under local government statute and as such will be subject to public procurement requirements, as will the Joint Committee. The Joint Committee will be made up of the Leaders of participating London borough councils and each borough that becomes a shareholder in the ACS Operator would appoint a representative to sit on the Joint Committee with the power to act for the borough in exercising its rights as a shareholder. It is suggested that for specialist matters, e.g. investment matters, the chair of the pensions committee would deputise for the Leader. In essence, members of the Joint Committee would be elected members.

Directors of the ACS Operator would be appointed by the shareholders and would appoint the necessary service providers to operate the Fund. Importantly, in this model the intention is for decisions on asset allocation and manager selection to remain with the borough councils, and for manager selection via the Joint Committee.

This structure appears to be intended more as an incentive for boroughs to join rather than as the best governance model, and appears extremely complex. However, this example may help Dorset consider issues more relevant to their own position.

In some respects, the governance for a CIV would be no different from a decision to invest in pooled funds but the establishment of CIVs would no doubt place peer pressure on funds to invest in these vehicles, and this is relevant to the Government’s second proposal.

## Proposal 2: Passive fund management of listed assets

This proposal is introduced as follows:

4.16 There are two main types of investment approach, which can be used individually or in combination.

- Passive management typically invests assets to mirror a market in order to deliver a return comparable with the overall performance of the market being tracked.
- An actively managed fund employs a professional fund manager or investment research team to make discretionary investment decisions on its behalf.

The conclusion that funds should make greater use of passive management is based on the report from Hymans Robertson that on average active management does not produce outperformance and that a move to passive management would result in significant savings in fees. It is important to note that the figures produced by Hymans Robertson are based on averages across all LGPS funds and the cost savings are based on all listed assets being managed passively.

The question is posed as follows:

4.30 The Government therefore wishes to explore how to secure value for money for taxpayers, Scheme members and employers through effective use of passive management, while not adversely affecting investment returns. There is a range of options open to Government and the funds to achieve this:

- Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.
- Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.
- Fund authorities could be required to manage listed assets passively on a “comply or explain” basis.
- Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report

**Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson’s evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?**

All the options suggested have significant governance implications for the Dorset Fund, whether imposed by regulation or by oversight, let alone the investment implications, and will require careful consideration.