

REPORT PREPARED FOR

Dorset County Pension Fund

**Meeting of the Pension Fund
Committee on 24th June 2015**

Governance Compliance Update

11th June 2015

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Introduction

This is my seventh 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 2014 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 new regulations and guidance have been issued in relation to new governance arrangements, there has been no progress on proposals for investment restructuring.

Notwithstanding the upheaval in operational and transitional arrangements in regard to the new LGPS 2014, 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 2014 and I am satisfied that governance standards are being maintained and improved.
- ✓ There have been significant regulatory changes affecting the governance arrangements in relation to the establishment of the Local Pension Board.
- ✓ Regulated guidance has been issued by the Pensions Regulator (tPR) recently which requires consideration.
- ✓ DCLG has introduced regulated guidance, published by CIPFA, on the preparation of annual reports and this identifies some areas for attention.
- ✓ The DCLG's proposals in 2014 on opportunities for collaboration, cost savings and efficiencies, which have been subject to consultation, remain dormant but may be resurrected by the new Government.

Recommendations

- [1] That the guidance from the Scheme Advisory Board and Code of practice No. 14 from tPR are reviewed with the Local Pension Board to identify a programme of business and key tasks, and report back to the Committee.
- [2] That the revised Governance Compliance Statement is agreed and submitted to the DCLG.
- [3] That tPR compliance and enforcement policy is reviewed by both the Committee and the Board.
- [4] The preparations are made to submit information for reviews by the three regulatory bodies as and when required.
- [5] That the CIPFA guidance on preparing annual reports is reviewed carefully in preparing the annual report for 2014-15

Core business activity

A review of the Committee's core business activity at meetings since June 2014 confirms that governance standards continue to be maintained and improved where necessary. I note in particular a satisfactory audit report on the Fund's accounts and controls, and the approval of a revised Statement of Investment Principles and a Funding Strategy Statement in June; a revised Discretions Policy in September; and a revised Treasury Management Strategy and a revised Communications Policy in March this year.

The new Local Pension Board has been established in line with the regulations and guidance, and its members appointed for a first meeting in June. The Committee maintains a robust approach to strategic investment issues and the monitoring of investment activity and performance. Changes in investment mandates have been implemented in line with statutory requirements and in line with good practice.

There has been a significant rise in regulatory demands for compliance monitoring and reporting and I report below on some further issues that the Committee will need to address. Nevertheless, in my view this does not impact on the Committee's continuing high standards of governance in transacting business.

New regulations on governance

The new governance regulations [SI 2015/57] were finally made at the end of January. In essence, these introduce new clauses into the Scheme regulations 2013 to cover delegation, local pension boards, scheme advisory board, scheme actuary, employer cost cap, and some additional functions for the scheme advisory board relating to cost assessment.

The Committee has considered the issues in relation to local pension boards on various occasions and has established a Board for Dorset in line with the regulations. I provided advice to the officers on the preparation of terms of reference and other related matters last autumn and I am satisfied that the board has been properly established in accordance with the regulations and in the timescale allowed.

With the issue of regulations there followed copious guidance from the Scheme Advisory Board and the Pensions Regulator to which I refer in more detail below. The key role of the Dorset Pension Board, described in detail in the regulations and guidance, will be to assist the Committee in compliance with the regulatory provisions and to ensure the effective and efficient governance and administration of the LGPS.

These are onerous responsibilities to which the Board will be able to add employer and scheme member perspectives. This will be particularly useful in shaping communications and documentation, and in representation of interests in the governance of the Scheme.

This introduces a new era of regulatory oversight which is both extensive and complex, involving the DCLG, the Scheme Advisory Board and tPR. While guidance and codes of practice are not statements of the law, they provide the benchmark against which compliance with the law will be monitored and tested, and ultimately enforced.

Guidance from the Scheme Advisory Board

The final form of this guidance was issued on 4th February and provides details about the establishment of local pension boards and their operation. This has been used by the officers in setting up the Dorset Local Pension Board. Other parts of the guidance deal with knowledge and understanding, conduct and conflicts of interest, reporting and resourcing.

The Board will need to familiarise themselves with the contents of the guidance and in particular, the policy documentation in force for Dorset, which is listed in the guidance in generic terms. Information is also given on the key areas of law on which Board members will need to develop their level of knowledge and understanding.

I have not gone into more detail in this report as these will be issues for the Board to consider but of which the Committee should be aware. I have been invited to attend the first meeting of the Board to provide some initial training on the background. It is likely that most of the Board members will not be familiar with much of the documentation and law, and there will be a steep learning curve.

Code of practice No. 14 from tPR

The Code applies to all public service pension schemes and is not therefore LGPS specific. However, much of the detail relates the new requirements for pension boards and to issues already applied to LGPS from past pensions legislation (e.g. reporting breaches). It should be noted that some elements of the Code apply to local pension boards and some to administering authority responsibilities, but of which the boards should be aware.

The guidance issued by the Scheme Advisory Board helpfully summarises the areas covered by the Code and in particular, issues relating to local pension boards, and provides a cross reference to the Code - I have provided this list in **Appendix A**. I have not provided further analysis in this report but it will be important for the Committee and the Board, together with the officers, to develop an operational understanding of these matters and their different responsibilities.

I have referred previously to some lack of clarity over investment issues. The Board is not given responsibility for the investment of the fund other than in ensuring compliance with the law and regulations. No doubt 'grey' areas will, and are beginning to emerge elsewhere, in the application of the new arrangements and the role of tPR. The following paragraph from the Scheme Advisory Board guidance is pertinent:

"4.9 For the avoidance of doubt the powers of the Regulator" (i.e. tPR) "were not extended to cover areas such as the funding and investment of Funds."

tPR compliance and enforcement policy

This document was published on 4th June and applies to all public service pension schemes. It sets out their approach to regulation and to risk; monitoring and reviewing their compliance activities and their risk-based prioritisation; their activities to support compliance and enforcement, including education and enablement, and thematic reviews; and provides information on how investigations will be undertaken.

At this stage I have not sought to analyse this policy but in essence it sets out the rules by which they will operate and with which scheme managers and local pension boards will need to be familiar. Their risk based prioritisation, however, provides a useful framework for guiding operations and expectations - see **Appendix B**.

Additionally it states:

"In prioritising risk-based regulatory activities, we will consider factors such as schemes' ability and willingness to put matters right and the likely impact of the various types of intervention available to us. We will adopt a 'test and learn' approach to investigations and regulatory action in relation to public service pension schemes.

Monitoring and reporting

It appears that there will be a significant amount of monitoring of activities.

DCLG has indicated informally that they intend to undertake two surveys, the first in the summer to gauge progress and to make sure that all the local boards have been more or less fully established with arrangements for first meetings. They will then follow this up in early 2016 with a more formal survey, possibly in conjunction with tPR. Part of this would be to ask for copies of governance compliance statements which, under the 2013 regulations, must include a statement on local pension board arrangements.

The Committee is due to consider a revised Governance Compliance Statement at this meeting. I have given comments to officers on the draft and I am satisfied that that it is in compliance with the new regulation.

In terms of what DCLG would be looking for, the first survey is to be a simple compliance check against the governance regulations. The second survey in early 2016 would focus more on progress, effectiveness, scope of workplans, etc. but this may be subject to discussion in the autumn following the first survey.

The Pensions Regulator states in their compliance and enforcement policy as follows:

"We plan to use a governance and administration survey, conducted in 2015, to baseline standards and monitor improvement in the following years. We will also learn through our early scheme engagements and feed that learning into the development of our risk-based approach." [See Appendix 2]

Informally I have been told that *"they will shortly be sending out a survey questionnaire on the governance and administration of the public service schemes. They will also be contacting schemes in July to notify them that the on-line scheme registration system ("Exchange") has been updated to hold the additional required information about public service scheme (e.g. pension board members), and to remind them that they should update the information about their scheme held on 'Exchange' with this additional information."*

Scheme Advisory Board is also said to be looking at progress on establishing local pension boards, and is reporting on individual annual reports, plus there is likely to be other monitoring activity as the Board is fully established. Currently their website contains details of the Dorset annual report for 2013-14 - see below.

The Scheme Advisory Board, in the guise of Brian Strutton (GMB), was reported in the press recently saying that cost savings through mergers and passive investing were no longer their priority but that they would be focusing on scheme deficits. Interestingly they say they intend to measure all LGPS deficits accurately, advise funds on how they should manage their deficits, provide direct help to struggling funds, and make proposals for reducing the burden of deficits.

One further point relates to the way in which the Scheme Advisory Board is reporting on individual annual reports. Below is an extract of the entry for Dorset:

Dorset	Annual report 2014 pdf, 56 pgs, 952.50Kb	Communications Policy Statement, PDF, 11 pages, 290Kb Funding Strategy Statement, PDF, 7 pages, 110Kb Governance Compliance Statement, PDF, 11 pages, 42Kb Statement of Investment Principles, PDF, 12 pages, 74Kb
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Clearly this is a rather simplistic guide to the location of certain key documents, each giving a web link to the document itself which in itself is useful. It also provides an indicator to what will be expected and reported in the future. However, the policy statements are not included in the Dorset Annual Report (a decision taken in 2013-14) although this implies they are. This leads to consideration of recent guidance on preparing the annual report.

Preparation of Annual Reports

In August 2014, DCLG issued guidance published by CIPFA under the provisions of Regulation 57(3) of the LGPS Regulations 2013 which requires an administering authority to have regard to the guidance when preparing and publishing their pension fund annual report. It was further stated that where an administering authority had already prepared its annual report for 2013-14, it should review that report to ensure compliance with the guidance.

As usual the guidance was issued at a particularly late stage in the annual reporting process and I have taken the opportunity to undertake that review in brief form in **Appendix C**.

I have not provided details of the elements of the guidance which cover some 20 pages but it is clear that what appears to be a comprehensive guide to best practice has been turned into a mandatory regulatory requirement - the same mistake occurred with the updated Myners Principles.

My analysis shows the Dorset Report as being not compliant or partly compliant in most areas and for two key reasons:

- Policy statements must now be included in the Report in full. This change in interpretation is affecting many funds.
- The guidance introduces new areas of reporting which will have to be developed for 2014-15. In some cases the Dorset Report for 2013-14 refers to this being done.

Whatever one might think of the details in this guidance (e.g. the analysis of fund assets between “UK, Non-UK and Global” will be a challenge), it will become the benchmark against which the Scheme Advisory Board will measure future reporting and the report for 2014-15 will need to be adapted accordingly.

Future structure of the LGPS

Despite various rumours, the Government did not publish any response to its consultation on proposals on opportunities for collaboration, cost savings and efficiencies before the start of purdah for the General Election. It is not at all clear at this stage whether these proposals will remain dormant, be reinstated and implemented, and in the same or a different form.

I understand that work has been underway to review the structure of the investment regulations which has been an on-going issue for the past 15 years. It is unlikely that anything will emerge until the future of the consultation on restructuring is determined.

Peter Scales
11th June 2015

An extract from the guidance on the creation and operation of LGPS local pension boards issued by the Scheme Advisory Board on 4th February 2015

4. The Pensions Regulator

4.6 The Regulator has issued the Code of Practice which covers:

4.6.1 knowledge and understanding required by pension board members (see paragraphs 33 to 60 of the Code of Practice);

4.6.2 conflicts of interest and representation (see paragraphs 61 to 91 of the Code of Practice);

4.6.3 reporting breaches of the law (see paragraphs 241 to 275 of the Code of Practice);

4.6.4 publishing information about schemes (see paragraphs 92 to 99 of the Code of Practice);

4.6.5 internal controls (see paragraphs 101 to 120 of the Code of Practice);

4.6.6 scheme record-keeping (see paragraphs 122 to 146 of the Code of Practice);

4.6.7 maintaining contributions (see paragraphs 147 to 186 of the Code of Practice);

4.6.8 providing information to members (see paragraphs 187 to 211 of the Code of Practice) ; and

4.6.9 internal dispute resolution (see paragraphs 213 to 240 of the Code of Practice).

4.7 However, only the areas of knowledge and understanding, conflicts of interest and representation and reporting breaches of the law have direct application to Local Pension Boards. The other areas apply to Administering Authorities, although there are areas that a Local Pension Board will need to be aware of in order to assist the Administering Authority.

Extract from tPR compliance and enforcement policy issued on 4th June 2015

2.3 Risk-based prioritisation

When undertaking risk assessment, we will focus on risks in the following critical areas:

Knowledge and understanding⁴

Members of pension boards must comply with the requirement to have the appropriate knowledge and understanding, to be able to assist their scheme manager effectively. Failure to do so is a breach of law.

⁴ As required under section 248A of the 2004 Act.

Conflicts of interest⁵

Scheme managers must ensure that pension board members do not have any conflicts of interest. A failure to do so is a breach of the law and could, for example, result in the advice and/or decisions of the pension board being open to challenge and, ultimately, the ineffective governance of the scheme.

⁵ Scheme regulations must require scheme managers to be satisfied that pension board members do not have a conflict of interest (section 5(4) of the Public Service Pensions Act 2013).

Records⁶

Legislation specifies the records that must be kept and failure to comply is a breach of the law. The completeness and accuracy of these records will be key to the effective and efficient operation of schemes, including ensuring that the right benefits are paid to the right person at the right time. This will be supported by operating appropriate internal controls.

⁶ Section 16 of the Public Service Pensions Act 2013 and the Public Service Pensions (Record Keeping and Miscellaneous Amendments) Regulations 2014 (in particular).

Internal controls⁷

Scheme managers must establish and operate internal controls. Failure to comply with this requirement is a breach of the law and it may also result in schemes not being run in accordance with the law and/or risks not being identified, mitigated and managed properly.

⁷ Section 249B of the 2004 Act

Member communication⁸

The quality of the information provided to members in terms of accuracy, timeliness and clarity is an important factor in achieving good member outcomes. Failure to comply with disclosure requirements is a breach of the law and may indicate incomplete or inaccurate record-keeping and/or inadequate internal controls.

⁸ Section 14 of the Public Service Pensions Act 2013, section 113 of the Pension Schemes Act 1993 and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (in particular).

Dealing with internal disputes⁹

Where we become aware of matters that are raised under internal dispute resolution procedures, this can be an indicator of wider systemic issues which may impact the effective governance and administration of schemes.

⁹ Dispute resolution procedures must be made and implemented in accordance with section 50 of the Pensions Act 1995.

CIPFA Guidance for LGPS Funds on preparing the annual report

A compliance check for the Dorset report for 2013-14

A: MANAGEMENT AND FINANCIAL REPORT Scheme management and advisers	FULLY COMPLIANT
Risk management	MAINLY COMPLIANT No mention of third party risk
Financial performance	NOT COMPLIANT Does not contain the required information on financial (not investment) performance
Administrative management performance	PARTLY COMPLIANT No performance indicators nor details of contributions paid by each employer
B: INVESTMENT POLICY AND PERFORMANCE REPORT	PARTLY COMPLIANT No comparison of planned and actual asset allocation; no 10 year performance data; no information on organisational memberships; no record of where and how voting rights have been exercised; no record of actions taken on responsible investment; no details of custody arrangements; and no commentary on the implementation and application of the funding strategy statement.
C: SCHEME ADMINISTRATION REPORT	NOT COMPLIANT No review of administration arrangements or details of key areas of technology used; no data quality information; no details of arrangements for gathering assurance; and no details of IDRP cases.
D: ACTUARIAL REPORT ON FUNDS	MAINLY COMPLIANT No direction to full version of the actuarial report
E: GOVERNANCE COMPLIANCE STATEMENT N.B The Committee is due to consider a revised statement at this meeting	NOT COMPLIANT A full copy of the statement is not included in the report. CIPFA also suggests some commentary to illustrate the policies in practice [not mandatory]
F: FUND ACCOUNTS, NET ASSETS STATEMENT AND NOTES	FULLY COMPLIANT
G: PENSIONS ADMINISTRATION STRATEGY REPORT	NOT COMPLIANT No details of service standards and performance.

<p>H: FUNDING STRATEGY STATEMENT</p>	<p>NOT COMPLIANT A full copy of the statement as it stood at the end of the reporting period is not included in the report and this should highlight any changes during the year.</p>
<p>I: STATEMENT OF INVESTMENT PRINCIPLES</p>	<p>NOT COMPLIANT A full copy of the statement is not included in the report.</p>
<p>J: COMMUNICATIONS POLICY STATEMENT</p>	<p>NOT COMPLIANT A full copy of the statement is not included in the report and no information is given about implementation.</p>
<p>K: ANY OTHER APPROPRIATE MATERIAL</p>	<p>PARTLY COMPLIANT No information on the role played by auditors in providing assurance, exercise of employer discretions, or a glossary.</p>
	<p>The guidance also refers to some specific requirements in relation to numbers of employers, analysis of fund assets and investment income, and the tabulated form which will need to be reviewed.</p>