DORSET COUNTY PENSION FUND

Governance Compliance Update

Pension Fund Committee on 11th March 2021

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1.0 Introduction

1.1 I last presented my annual review on the governance arrangements for the Dorset County Pension Fund at the Committee on 27th November 2019. While I would usually have expected to report again in the autumn of 2020, given the temporary pausing of LGPS developments nationally it was agreed to defer my review to 2021. I submitted an interim update to the officers in October 2020.

1.2 As for all local authorities, the past 12 months has been a period of unparalleled uncertainty due to the COVID-19 pandemic and the need to create a whole new way of working. This has been an extreme test for governance arrangements and compliance, and the challenges remain. Nevertheless, the Dorset County Pension Fund has adapted well and maintained governance standards.

2.0 Committee and Board meetings

2.1 Both the Committee and the Local Pension Board have adapted their meeting arrangements to enable virtual meetings to take place. It should be noted that the regulations allowing such meetings expire on 7th May unless extended. Notwithstanding the legal position, it is important to ensure that no members are unnecessarily excluded due to the nature of these meetings, and that the ability of members to contribute to discussion is not compromised.

2.2 My experience from other LGPS funds is that while virtual meetings are happening, they are not the preferred option and represent a potential weakness in the governance arrangements. On the other hand, virtual meetings can make it easier for some to attend and for more members of the public to listen to proceedings if not participate.

2.3 I am pleased to note that the Local Pension Board is holding regular meetings and that details are available on the pension fund website. This was an issue that I have commented on before but has now been resolved and with good attendance at meetings.

3.0 Core business activity

3.1 I have looked through the public papers for both the Committee and the Board and read the minutes of each meeting. I listened to part of the webcast of one of the Committee's meetings. This only provides me with a partial oversight of proceedings but enough to satisfy me that the meetings are being run well in governance terms and are covering the broad range of responsibilities.

3.2 For the Committee, I note that administration is a regular item on each agenda as are investment issues and that the profile of performance against KPIs has been raised during the pandemic in order to monitor the impact of home working. Other important areas covered include data quality, ABIs, AVC arrangements and the annual report which I refer to below.

3.3 For the Board, the business considered has been wide ranging and highly relevant to the Board's role. The Committee chair has attended two meetings which is a sign of a good working relationship between the Committee and Board. The Committee may wish to consider receiving the minutes of the Board meeting at each of its meetings to further evidence good governance in practice.

3.4 The reference to the items of business being considered is pertinent to the outcome of the Good Governance Review to which I refer in more detail below. The proposals from that review suggest that a key performance indicator to measure will be the frequency that core items are considered.

4.0 Annual Report

4.1 I have read through the annual report for 2019-20 and consider that, as in 2018-19, the report is well written and informative. In my opinion, the annual report is compliant with the regulations (Reg 57) and has regard to the guidance as issued by CIPFA.

5.0 Regulations and Guidance

5.1 Inevitably, the impact of the COVID-19 pandemic has slowed progress on a number of regulatory and guidance matters. Furthermore, it would appear that MHCLG has a 'build-up' of regulatory matters requiring their attention but do not have sufficient resources to deal with them. I set out below the status on the key issues:

McCloud judgement – MHCLG's response to the consultation on proposed changes to the regulations to implement satisfactory 'McCloud remedies' is expected imminently. There will be governance issues to consider in ensuring compliance with the new regulations, preparing and managing the required data, and ensuring resources are sufficient to meet any deadlines set. In particular, there are issues in relation to communications in order to avoid confused messages, including the annual benefit illustrations due in the summer.

£95K exit cap – The regulations that were published on proposals to cap public sector exit payments were in conflict with LGPS regulations and were facing judicial review. The Treasury has recently revoked their application to LGPS although not retrospectively. While this may avoid immediate concerns, there is still some confusion about the legal position which will add to the administrative burden. Furthermore, the issues have not gone away and further legislation is expected.

Pooling arrangements – MHCLG issued an informal consultation in January 2019 which was subsequently withdrawn for revision following a significant amount of criticism and challenge. As it stands, there is no mandatory guidance in place regarding the implementation of pooling, other than to report policy in the ISS. It is not clear when revised guidance will be issued.

Investment strategy guidance – Revised guidance on the preparation of the investment strategy statement is awaited following the Supreme Court judgement in favour of the Palestine Solidarity Campaign handed down on 29th April 2020. In broad terms, the position is that MHCLG can regulate how funds are invested through statutory regulations but cannot determine the choice of individual investments through guidance. It is not clear how MHCLG will progress this issue. The position is to some extent exacerbated by indecision over pooling guidance and issues about responsible investment.

Responsible Investment guidance – SAB issued guidance on responsible investment which included their views on the meaning of 'fiduciary duty'. This was heavily criticised and subsequently withdrawn. They are currently working on an on-line A-Z guide to responsible investing but without reference to fiduciary duty. Any further attempt to define that will most likely be affected by the Supreme Court judgement and any changes to investment guidance (but see reference below under Good Governance). It seems likely that there will be pressure on MHCLG to regulate on responsible investment and climate change in some way, although this may require secondary or even primary legislation.

Climate risk disclosure – The recent Pensions Schemes Act will require the largest occupational pension schemes to publish climate risk disclosures by the end of 2022 (£5bn + of assets) and by the end of 2023 (£1bn + of assets). This will mean that such schemes are legally required to assess and report on the financial risks of climate change within their portfolios.

The requirements are to be regulated by tPR and failure to comply could be subject to mandatory penalty. It is not clear at this stage whether and how these requirements might be applied to LGPS funds, given that tPR does not have regulatory authority over LGPS investments. It is possible that this could be achieved through MHCLG guidance and it will be important to monitor the position.

The Act also contains new requirements, e.g. pensions dashboard, funding requirements, which may be applied to the LGPS. This would require extensive consultation but might be used to find solutions to the various investment related regulatory and guidance issues that I have outlined above.

Changes to the local valuation cycle and management of employer risk – MHCLG published a partial response to last year's consultation which includes the review of employer contributions between valuations, spreading exit payments and deferred debt arrangements. The changes came into force on 23rd September, requiring a review of the Funding Strategy Statement. It is not yet clear how the transition to quadrennial valuations will be managed or the implications for the cost cap mechanism.

5.2 All these issues and potential changes will impact upon the governance framework and timescales are likely to be truncated due to the loss of momentum during the pandemic. They will also further complicate the requirements for compliance, knowledge and understanding on both the Committee and the Board.

6.0 Good Governance review

6.1 Hymans Robertsons' final report on good governance was agreed by the SAB on 8th February although details have only emerged recently. At this stage, we have details of the proposals being put forward to MHCLG for consideration of the regulatory and guidance changes that are sought. There is no indication of when this might happen.

No doubt the officers will be considering these proposals and reporting to the Committee and Board in due course. However, I have highlighted below what might be some of the key governance issues:

- New statutory guidance on governance compliance to replace the 2008 guidance
- Requirement to produce an (enhanced) annual governance compliance statement
- Need to have a single named officer responsible for the LGPS function
- Conflict of interest requirements specific to pension fund
- Guidance to refer to fiduciary duty
- Policy on representation on the Committee and voting rights (admin authority can keep majority)
- Stronger requirements on Committee and officers for LGPS knowledge and understanding
- Administration strategy statement to become mandatory
- Performance to be monitored against a set of Key Performance Indicators
- Clear business planning processes for LGPS functions
- Independent governance review every two years to be assessed by SAB 'experts'
- Possible peer review process

6.2 Many of the changes are to update the governance arrangements that have been in place for over 12 years with little change. However there are some distinct expectations around separating out the LGPS function and boosting its status in the organisation, raising perceived standards of knowledge and understanding, representation, reporting and independent oversight and assessment.

6.3 Many of these themes have been in evidence since the mid-1990s, in 2008 when the current framework was introduced, and in 2014 when local pension boards were introduced for all public sector schemes. Even though the proposals may not change, per se, the high level of governance currently in the Dorset County Pension Fund, they will require more monitoring and reporting, and outside interference.

7.0 The Pensions Regulator

7.1 The Pensions Regulator published the results of their 2019 survey in November 2020. The survey covers eleven different areas including annual benefit statements, reporting breaches, managing risk and cyber risk. The main items to note are:

- Most key administration processes are automated to some extent
- Main barriers to automation are lack of technology, integrating existing systems and cost
- Schemes have a greater range of cyber risks in place than last year
- Most schemes had completed a data review with improvement plans in place
- Regulatory complexity and the volume of changes were key barriers to improving governance
- The McCloud judgement was a major concern
- Lack of resources and retention of trained staff were concerns

7.2 It should be noted that the survey was issued in November 2019 so the results are about one year old. Nevertheless, tPR uses the results of these surveys to direct their future plans and focus areas. The 2020 survey was due to be returned by mid February.

7.3 Progress on the Regulator's plans to prepare a single modular code of practice have been delayed by the pandemic but a formal consultation is expected in the near future. TPR's early focus remains on the codes most affected by the regulations, and those which are applicable to the fund include Code of Practice 9 (internal controls) and content from Code of Practice 14 (public service schemes).

7.4 Administering authorities, including local pension boards, will need to be able to demonstrate that they have an effective system of governance within 12 months of publication of the updated code. It is not clear how this relates to the SAB governance review and whether any conflicts will emerge, particularly as tPR does not distinguish between the unfunded public sector schemes and the LGPS.

8.0 Conclusions

- ➢ The Dorset County Pension Fund continues to maintain good governance principles.
- ➢ Despite the distractions imposed by the pandemic and the need for alternative working arrangements, the overall administration of the fund has continued to operate well.
- ➢ The governance framework looks set to become more complex and more onerous during the coming year.
- ➢ There are competing demands from the various interested parties and regulators to introduce new controls, guidance and standards, e.g. SAB, LGA, CIPA, tPR, MHCLG, Treasury.
- ➢ There does not appear to be a clear objective that change should benefit scheme employers and members other than an implicit expectation of improved governance.