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LONDON BOROUGH

# PENSIONS COMMITTEE AGENDA

| 7.30 pm | Wednesday 24 July 2013 | Committee Room 3A - Town Hall |
|---|---|---|

Members 7: Quorum 3

**COUNCILLORS:**

| Conservative Group (4) | Residents' Group (1) | Labour Group (1) | Independent Residents' Group (0) |
|---|---|---|---|
| Becky Bennett (Chairman)<br>Melvin Wallace (Vice-Chair)<br>Steven Kelly<br>Roger Ramsey | Ron Ower | Pat Murray | |

**Trade Union Observers**

**(No Voting Rights) (2)**

John Giles, (Unison)
Andy Hampshire, GMB

**Admitted/Scheduled Bodies Representative**

**(Voting Rights) (1)**

Marilyn Clay


**For information about the meeting please contact:**
**James Goodwin 01708 432432**
**email: james.goodwin@havering.gov.uk**

## AGENDA ITEMS

**1 CHAIRMAN'S ANNOUNCEMENTS**

The Chairman will announce details of the arrangements in case of fire or other events that might require the meeting room or building's evacuation.

**2 APOLOGIES FOR ABSENCE AND ANNOUNCEMENT OF SUBSTITUTE MEMBERS**

(if any) - receive

**3 DISCLOSURE OF PECUNIARY INTERESTS**

Members are invited to disclose any pecuniary interest in any of the items on the agenda at this point of the meeting.

*Members may still disclose any pecuniary interest in any item at any time prior to the consideration of the matter.*

**4 URGENT BUSINESS**

To consider any other item in respect of which the Chairman is of the opinion, by reason of special circumstances which shall be specific in the minutes that the item should be considered at the meeting as a matter of urgency.

**5 INVESTMENT IN LOCAL INFRASTRUCTURE** (Pages 1 - 10)

Report attached.

**6 REVIEW OF STATEMENT OF INVESTMENT PRINCIPLES** (Pages 11 - 30)

Report attached.

**7 LOCAL GOVERNMENT PENSION SCHEME - DISCUSSION PAPER ON NEW GOVERNANCE ARRANGEMENT** (Pages 31 - 50)

Report attached.

## 8 EXCLUSION OF THE PUBLIC

To consider whether the public should now be excluded from the remainder of the meeting on the grounds that it is likely that, in view of the nature of the business to be transacted or the nature of the proceedings, if members of the public were present during those items there would be disclosure to them of exempt information within the meaning of paragraph 1 of Schedule 12A to the Local Government Act 1972; and, if it is decided to exclude the public on those grounds, the Committee to resolve accordingly on the motion of the Chairman.

**Andrew Beesley**
**Committee Administration Manager**

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|---|---|
| **SPECIAL PENSIONS COMMITTEE**<br>**24 July 2013** | **REPORT** |

| | |
|---|---|
| **Subject Heading:** | Investment in Local Infrastructure |
| **Report Author and contact details:** | Mike Board<br>Corporate Finance & Strategy Manager<br>01708 432217<br>mike.board@havering.gov.uk |
| **Policy context:** | Pensions Investment Strategy |
| **Financial summary:** | There are no immediate financial implications. Additional costs may need to be incurred to develop options for consideration by the Committee. |

**The subject matter of this report deals with the following Council Objectives**

| | |
|---|---|
| Clean, safe and green borough | [] |
| Excellence in education and learning | [] |
| Opportunities for all through economic, social and cultural activity | [] |
| Value and enhance the life of every individual | [x] |
| High customer satisfaction and a stable council tax | [x] |

**SUMMARY**

To consider and approve the governance arrangements for Investing in Local Infrastructure Assets for the benefit of the Pension Fund.

**RECOMMENDATIONS**

The Committee is asked to consider and approve:

a) The operational guidelines (as set out in paragraph 2).

b) The project selection, evaluation and approval process (as set out in paragraph 3)

c) The selection criteria (as set out in paragraph 4)

d) The reporting requirements (as set out in paragraph 5)

e) The Committee is also asked to recommend to the Governance Committee changes to the constitution relating to the Committee's powers in relation to infrastructure investment (as set out in paragraph 9).

The Committee is also asked to consider whether it wishes to delegate the Investment decision making to a smaller member sub committee (para 3.4)

**REPORT DETAIL**

1. **Background**

On the 30 April 2013 the Pensions Committee received an outline report on the creation of a Local Infrastructure Asset class. The Committee agreed to the proposal in principal and requested that officers bring forward a report that would enable it to consider and approve the governance arrangements.

A separate report is included elsewhere on this agenda for the approval of an updated Statement of Investment Principles in order to incorporate a local infrastructure asset class.

2. **Operational Guidelines**

The following principles have been taken into consideration in establishing the operational guidelines for the management of the new asset class.

- Investments should comply with the Pension Fund's existing investment strategy with regard to the required rate of return and risk appetite.

- The Investment should not place undue pressure on cashflow.
- The sourcing, execution and management of local investment opportunities should not overburden the Pension Fund's existing resources.
- The Governance arrangements for the portfolio should be clear and well developed.
- The Pension Fund wishes to benefit from both capital appreciation and income generation

It is recommended that the following operational guidelines are established for the management of the portfolio.

| Principle | Parameter |
|---|---|
| **Target Sector** | Housing:<br><br>• Open Market & Affordable/Social Housing<br>• Rental or units for sale<br><br>Commercial Property Development<br><br>Leisure Development<br><br>Public sector infrastructure projects |
| **Target Return** | The target return is 2.6% pa net of fees in real terms based upon the latest actuarial report and updated on a triennial basis. The target return will reflect both capital appreciation and income generation. |
| **Risk Appetite** | The PF is willing to consider exposure to the following risks, subject to the appropriate due diligence, risk management techniques and adequacy of return.<br><br>• Construction risk<br>• Demand risk<br>• Availability Risk<br>• Counterparty credit Risk |
| **Investment Products** | The PF is flexible around the type of product it might use. |
| **Leverage** | Leverage will be factored into the risk assessment and considered on a project by project basis. |
| **Time Horizon** | Both long term and short term investments. |
| **Exclusions** | Investments are limited by the target sector and the asset class. Individual projects should be at least £750k in value. No specific products have been excluded |
| **Allocation Limits** | The initial allocation is 3% of pension fund assets as set out in the statement of investment principles |

## 3. Project Selection, Evaluation and Approval

3.1 As discussed in the previous report to the committee on 30 April 2013 the current governance arrangements are based upon an external Fund

Manager structure. Due to the localised nature of the proposed portfolio and the relatively small proportion of the fund's allocation to local infrastructure the following arrangements are proposed.

a. Internal Investment Manager

The Group Director (Resources) will appoint the Internal Investment Manager (IIM), initially the Property Services Manager. The IIM will:

- Act as first point of contact for potential investments
- Pro-actively search for new investment opportunities
- Consider investment opportunities brought forward by third parties
- Carry out initial screening of investment opportunities to determine those with potential to meet the Investment criteria
- Refer and present suitable investment opportunities to the Infrastructure Evaluation Panel

b. Infrastructure Evaluation Panel

The Infrastructure Evaluation Panel will consist of the Group Director Resources (chair), Head of Finance and Procurement, Corporate Finance and Strategy Manager and the Assistant Chief Executive (Legal and Democratic Services) or their successor roles where appropriate. The panel will be considered quorate with a minimum of three members. In the absence of the nominated officers deputies may be accepted

The Panel will:

- Consider Investment opportunities presented to it by the IIM.
- Consider whether the investment proposal is subject to the requirements of the public procurement regime.
- Carry out a detailed appraisal of each Investment.
- Approve, by majority, those Investments meeting the required criteria to the Pensions Committee for consideration.

c. Project Approval

- The Pensions Committee will receive recommendations from the panel and will decide whether to proceed with the Investment. The decision to invest in a particular project remains with the Pensions Committee.
- The Committee may approve an investment in principle that is subject to the public procurement regime. As a consequence, the Director of Resources will be instructed to initiate a tender process in accordance with the Council's Procurement Framework.

- Where time is of the essence it may be necessary to call a Special Pensions Committee meeting to consider investment opportunities which might otherwise be lost to the Fund.

3.2 The Director of Resources will ensure that sufficient resources are made available to the panel to ensure that the necessary project evaluation work is carried out robustly. This work may be carried out by internal professional staff but in some instances external specialists may be engaged (see also paragraph 6).The level of resources will be kept under review taking account of the size of the portfolio and the complexity of the project (s).

3.3 These proposed arrangements are consistent with the Pension Fund's Funding Strategy Statement, Governance Compliance Statement and Statement of Investment Principles. However, a revision to the Council's constitution is required in order to allow the Committee to directly manage projects within the infrastructure portfolio. (See also paragraph 9)

3.4 Additional training on investment appraisal will need to be made available to Committee members in advance of the first referral by the IIP. Decisions may also need to be made outside the normal cycle of meetings although it is difficult to evaluate at this early stage. Committee is therefore asked to consider whether it wishes to delegate the project approval process to a smaller Investment sub – Committee consisting of a smaller group of members in order to better focus training needs on investment infrastructure appraisal and enable the decisions to be made promptly, as and when investment opportunities arise.

**4. Selection Criteria**

The IIM will carry out a simplified first filter in order to screen Investment opportunities. The Panel will need to carry out the second stage testing (due diligence) of schemes under consideration. The precise nature of the assessment will be determined on the characteristics of each scheme. However, the following table sets out the broad framework for the first and second stage tests.

| Test | First Filter | Second Filter – Due Diligence |
|---|---|---|
| Return Test | Does the potential return on investment meet or exceed the relevant return threshold? | Financial assessment including use of capital investment appraisal techniques. |
| Risk Test | Are the risks associated with the investment opportunity understood and mitigation strategies under consideration? | Risk measurement including use of sensitivity analysis, ratio analysis, credit ratings and any other appropriate measures. Assessment of options to mitigate risk |
| Size Test | Does the scheme conform to the size parameters for target investments? | Test the investment requirement to the parameters set out in operational guidelines |
| Investment Cash Test | Is there sufficient cash available to fund the project? | Financial assessment of Investment requirement Vs. current commitments and cashflow |
| Resource Test | Are there sufficient internal resources available to manage the proposed scheme? | Assessment of resource requirements to manage project. |

Further criteria may be added at a later stage in the event that the Pensions Committee wishes to increase its exposure to Infrastructure. Additional tests may include geographical exposure or the concentration of investments in asset types.

## 5. Reporting Requirements

5.1 The Pension Committee currently receives reports from its external fund managers. A comparable process is required for the monitoring of the local infrastructure portfolio. The precise format of monitoring reports may vary according to the nature of the approved schemes and it is expected that reporting will be developed over time to meet the requirements of the Pensions Committee and the Evaluation Panel. The IIM will be responsible for the submission of these reports based upon a format to be developed under the guidance of the Panel (and Corporate Finance). However, the following information is expected to be included;

**Quarterly**

- Investment Record
- Drawdown record
- Returns Record
- Performance record

**Annually**

- Year-end portfolio valuation
- Portfolio performance compared to benchmark
- Progress report on each project forming the portfolio

5.2. Reporting responsibilities

The Infrastructure Investment Panel will:

- Determine the format and content of investment monitoring reports
- Keep the performance of the portfolio under review
- Report and make recommendations where necessary in relation to the management of the portfolio.

The Internal Investment Manager will;

- Monitor the progress of the projects within the portfolio.
- Prepare and submit reports to the Pensions Committee and Infrastructure Investment Panel on progress and performance of infrastructure assets within the portfolio accordance within agreed timetables.
- Arrange for the formal valuation of assets held within the portfolio in order to comply with statutory and accounting requirements.

## 6. Engagement of Third Party Expertise

The IIM and the evaluation panel or the Committee may need additional specialist advice which is only available through the engagement of external professional advisors. This may take a number of forms, including:

a) Valuation: For example it is expected that external valuers will be engaged to carry out an independent valuation of the portfolio at year end.
b) Technical or  financial: For example to assess or evaluate a particular specialised asset or project
c) Legal : To examine specialised contracts or document or investment in third part contracts

The Director of Resources will engage the necessary support as required. The cost would fall upon the Pension Fund.

## 7. Role of the Pensions Investment Advisor

Under the existing governance arrangements the Pension Fund has appointed an Investment Advisor, Hymans Robertson to provide independent advice on the Fund's investment activities.

The advisor would be expected to provide advice to the Committee in relation to the infrastructure portfolio, in particular to the impact of the portfolio's performance on overall fund performance.

## 8. Procurement Framework

Any proposed investments may subject to the public procurement regime, but this will depend on the characteristics of each investment.

The public procurement regime applies to the purchase of supplies (goods), services or works above specified financial thresholds. The purchase of shares, or land would fall outside the public procurement regime. However, it would be necessary to examine the detailed proposals with great care as they may involve the purchase of associated services, or land development agreements, which could be subject to public procurement rules.

## 9. Constitution

9.1. The powers delegated to the Pensions Committee under the constitution do not explicitly refer to direct investment through the proposed local infrastructure portfolio. For clarity it is recommended that the following amendments to the constitution be referred to the Governance Committee.

- **Constitution section 1.2. Functions delegated to general council committees**
  The following paragraph be added to the Pension Fund powers

  **Infrastructure Investments**
  To receive consider and approve individual infrastructure projects forming the portfolio.
  To monitor and review the performance of schemes forming the infrastructure portfolio.

9.2 If the committee is minded to delegate the approval of schemes to a smaller member panel the Constitution would require a further amendment to that affect.

## IMPLICATIONS AND RISKS

**Financial Implications and risks:**

There are no immediate financial implications arising from the approval of the Governance arrangements. However, it is anticipated that additional contributions from the Council will be made available to invest in Infrastructure. In these circumstances the financial impact on the Fund would be as follows:

- An initial increase in Fund Valuation and a corresponding reduction in the Net Pension Liability.
- Increase in revenue stream arising from the use of assets.
- Potential increase in asset values and returns over time.
- Increased fund management and monitoring costs.
- Risk that the portfolio fails to achieve growth objectives for the fund.
- Risk that the cost of the investment in the project exceeds the initial estimate (for construction projects)
- Risk that on-going running costs are greater than planned, offsetting cash flow benefits and required rate of return.
- Risk of fluctuations in assets values or revenue streams which are out of step with actuarial assumptions.
- Risk of counterparty failure.

The cost of additional specialist advice required to support the process will fall on the Pension Fund. The requirements for the on-going selection and monitoring may also create financial pressures on the Fund especially if the portfolio grows over time. For that reason it will be necessary to review the resource requirements over the medium term

**Legal Implications and risks:**
While investing in the local infrastructure may be of benefit to the Council and local residents, this has to be secondary to the interests of the pension fund in securing a good return on its investment. In the event that the interests of the Pension Fund and the Council are in conflict then the interests of the fund must prevail.
It will be necessary to properly document investments in projects, particularly where they are run by bodies other than the Council, e.g. social landlords, to ensure that the terms of investment and any related security for the Council finance is secured.

**Human Resources Implications and risks:**

None arising directly from the consultation.

**Equalities implications and risks:**

None arising directly from the consultation.

**BACKGROUND PAPERS**

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|---|---|
| **PENSIONS COMMITTEE**<br>**24 July 2013** | **REPORT** |

| | |
|---|---|
| **Subject Heading:** | **REVIEW OF THE STATEMENT OF INVESTMENT PRINCIPLES** |
| **CMT Lead:** | **Andrew Blake-Herbert** |
| **Report Author and contact details:** | Debbie Ford<br>Pension Fund Accountant<br>01708432569<br>Debbie.ford@havering.gov.uk |
| **Policy context:** | Regulation 12 (1) of the LGPS (Management and Investment of Funds) Regulations 2009 requires an administrative authority to keep this document under review |
| **Financial summary:** | No financial implications |

**The subject matter of this report deals with the following Council Objectives**

| | |
|---|---|
| Clean, safe and green borough | [] |
| Excellence in education and learning | [] |
| Opportunities for all through economic, social and cultural activity | [] |
| Value and enhance the life of every individual | [X] |
| High customer satisfaction and a stable council tax | [] |

**SUMMARY**

In line with the Local Government Pensions Scheme Regulations (LGPS) and good practice the London Borough of Havering as an administrating authority undertakes a review of the Statement of Investment Principles (SIP). This report sets out how the review was undertaken and highlights where or if changes were necessary.

## RECOMMENDATIONS

That the committee:

1. Consider the strategy implications of introducing an infrastructure asset class (**Appendix B)**

2. Consider and agree the proposed amendments to the SIP (**Appendix A**).

## REPORT DETAIL

### 1. BACKGROUND

1.1 LPGS (Management and Investment of Funds) Regulations 2009 12(1) states that an administrating authority must prepare, maintain and publish a written statement of the principles governing its decision about the investment of fund money (this is known as Statement of Investment Principles).

1.2 The regulations, paragraph 12(3) also state that administrating authorities must prepare and publish a statement which states the extent to which an administrating authority complies or does not comply with guidance issued by the secretary of State. Where it does not comply it must state reasons for non compliance. (This is known as the Myner's principles).

1.3 Guidance as issued from the Secretary of State will be the guidance as published by the Chartered Institute of Public Finance and Accountancy (CIPFA) on 11 December 09 called 'Investment decision making and disclosure'.

1.4 The regulations as revised came into force with effect from the 1 January 2010.

### 2. <u>Statement of Investment Principles</u>

2.1 The Statement of Investment Principles was reviewed at the 26 March 2013 Pensions Committee meeting which also included the adoption of an interim amendment to the strategy. The interim strategy was adopted to address the funds need to rebalance an overweight position in equities and pending selection of multi-asset managers, assets were switched from equities to cash on a temporary basis. On the 22 May 2013 £20m was transferred from the State Street Global Asset Equity Mandate to a cash fund with the same manager.

2.2 The investment strategy that was agreed on the 26 March 2013 also included a statement that the Committee was considering introducing an allocation of assets to infrastructure. At a special Pensions Committee meeting held on the 30 April 2013 the committee then agreed to make an investment in Local Infrastructure and also requested officers to develop proposals for the creation of an infrastructure asset class.

2.3 The proposed revisions to the SIP can be seen on the track changes version attached as **Appendix A.** This reflects the changes made to the Statement of Investment Principles to show the introduction of a target allocation to an infrastructure asset class. The other classes have been reduced on a pro-rata basis to accommodate the introduction of the infrastructure allocation.

2.4 The other employers in the fund were notified of the intended revisions to the investment strategy and asset allocation changes earlier in the review process when changes were initially being considered. No views or comments were received at that time.

2.5 The revised SIP will be distributed to the Fund Managers and other employers following this meeting.

2.6 There is need to change the Myner's compliance table as a result of these changes, so this is not attached to the SIP.

**3. Strategy Implications**

**3.1** The Fund's investment advisor has produced a briefing paper attached as **Appendix B** which members are asked to consider. This outlines the strategy implications of the change to asset allocations following the introduction of an infrastructure asset class.

## IMPLICATIONS AND RISKS

**Financial implications and risks:**

There are no implications arising directly, however undertaking a review of the Investment Strategy on a regular basis will identify whether the investment objectives are being met and that they remain realistic. One of the Investment Strategy aims is to achieve a funding level of 100% on an on-going basis by 2030 whilst ensuring that investment objectives are being met and minimise any costs to the general fund.

**Legal implications and risks:**

None arise from this report.

**Human Resources implications and risks:**

None arise from this report.

**Equalities implications and risks:**

None arise from this report.

**BACKGROUND PAPERS**

Background Papers List
LGPS (Management and Investment of Funds) Regulations 2009
CIPFA publication investment decision making and disclosure Dec 09
Statement of Investment Principles March 2013

APPENDIX A

Havering
LONDON BOROUGH

# STATEMENT OF INVESTMENT PRINCIPLES

## JULY 2013

# STATEMENT OF INVESTMENT PRINCIPLES

## London Borough of Havering Pension Fund ('the Fund')

**Background**

**Legislation**

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1999 as amended require Local Authority Pension Funds to prepare a Statement of Investment Principles (SIP) and to review it at least every three years and without delay after any significant change in investment policy. They are also required to set out a Statement of Compliance with the six Principles of Investment Management contained in the CIPFA document "Principles for Investment Decision Making and disclosure" published in December 2009.

In preparing this Statement, the Pensions Committee has considered advice from the Investment Practice of Hymans Robertson LLP.

In relation to the Myners Code of Conduct for Investment Decision Making, the extent of the Fund's compliance with this voluntary code is summarised in the Appendix to this statement.

**Purpose and Scope of Scheme**

The London Borough of Havering is the Administering Authority for the London Borough of Havering Pension Fund. The Fund is part of the Local Government Pension Scheme (LGPS) and provides death and retirement benefits for all eligible employees and their dependants. It is a final salary defined benefit Pension Scheme, which means that benefits are payable based on the employees' final salary. All active members are required to make pension contributions which are based on a fixed percentage of their pensionable pay as defined in the LGPS regulations. Following the changes to the benefit structure of LGPS Schemes from 1 April 2008, active members previously paying contributions of 6% will pay banded rates between 5.5% and 7.5% depending on their level of full-time equivalent pay. Manual workers in employment before 1st April 1998 who previously had a protected 5% rate are subject to transitional rates.

The London Borough of Havering is responsible for the balance of the costs necessary to finance the benefits payable from the Fund by applying employer contribution rates, determined from time to time (but at least triennially) by the Fund's actuary.

The London Borough of Havering has a direct interest in the investment returns achieved on the Fund's assets, but the benefits paid to pensioners are not directly affected by investment performance.

**Pensions Committee**

A dedicated group of Councillors (the “Pensions Committee”) has been set up to deal with the majority of the Fund’s investment issues. Major investment decisions will be referred for consideration to the Pensions Committee. The Pensions Committee is made up of elected representatives of The Council who each have voting rights and Trade Union and Employer representatives who have observer status. Scheduled and admitted bodies may appoint one representative who is entitled to attend the meetings of the Pensions Committee on their behalf. Voting rights were assigned to this representative at a Full Council meeting on the 28 March 2012. The Pensions Committee reports to Full Council and has full delegated authority to make investment decisions. The Pensions Committee decides on the investment policies most suitable to meet the liabilities of the Havering Pension Fund and has ultimate responsibility for the governance of the Fund including Investment Strategy.

In particular, the Pensions Committee has duties that include:

- Monitoring the investment performance of the Fund on a quarterly basis;
- Determining overall objectives and strategy;
- Ensuring compliance with legislative requirements;
- Receiving the triennial valuation prepared by the Funds actuary with recommended contribution levels;
- Determining asset allocation and benchmarking;
- Appointment of Investment Managers.

The Pensions Committee is set up under the Local Government Act so that, where necessary, it can exercise decision-making powers. The Pensions Committee meets at least four times per year to hear reports from its officers, investment managers, actuary, investment adviser and performance measurement provider. Additional meetings are held as required in particular to ensure the appropriate Councillor training.

The Pensions Committee also receives and considers advice from executive officers of the Council and, as necessary, from its appointed external investment adviser (including specific investment advice), the actuary to the Fund and its investment managers.

The Regulations state that the Administering Authority must, when formulating its investment policy, have regard to the advisability of investing fund money in a wide range of investments and to the suitability of particular investments and types of investments.

**Fund Objective**

The purpose of the Fund is:

1. To pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses;

2. To receive monies in respect of contributions, transfer values and investment income.

The overriding aims of the Fund as set out in the Funding Strategy Statement are as follows:

- To ensure that sufficient resources are available to meet all liabilities as they fall due.

- To enable employer contribution rates to be kept as nearly constant as possible and at a reasonable cost to the Scheduled bodies, Admitted bodies and to the taxpayers.

- To manage employers' liabilities effectively.

- To maximise the income from investments within reasonable risk parameters.

For active members, benefits are based on service completed but take account of future salary increases. The value of liabilities is calculated consistently on the on-going basis set out in the formal report of the Fund's Actuary on the actuarial valuation carried out as at 31 March 2010. The fund's performance is monitored quarterly by the Pensions Committee and the funding position is formally reviewed at each triennial actuarial valuation or unless circumstances arise which require earlier action.

**Investment Objectives**

In framing investment strategy, it is recognised that the Committee has the long-term objective of being 100% funded on the current funding basis (i.e. with liabilities discounted at a rate of 1.8% p.a. in excess of gilt yields). The Committee is currently targeting to achieve this objective over the period to 2030.

The Committee wishes to pursue an investment strategy that retains at least a 60% chance of achieving this long-term objective. They have recognised that, over the ten year period from 31 March 2012, the required return from the Fund's assets to get "back on track" is around 6.5% p.a. more than the growth in the Fund's liabilities.

The Committee acknowledges this objective to be challenging and will therefore use this as a point of reference, rather than an explicit target. The Committee will monitor the development of the Fund's funding level on at least an annual basis to ensure the Fund remains on track and to identify any potential actions needed.

Based on advice from their Investment Adviser and a detailed review of strategy undertaken during 2012, the Committee has adopted a flexible investment strategy that reflects the following principles:

- Growth: The Committee recognises that a high allocation to “growth” assets/strategies is needed to achieve the long-term objective.

- Control: The Committee recognises that diversification can provide some protection against changing market conditions but that systemic risk cannot be diversified. The Committee therefore believes that greater dynamism within the investment strategy is desirable in order that the underlying strategy can be changed in response to changing market conditions.

- Income: The Committee recognises the emerging gap between income and benefit expenditure and hence the need to draw on investment income.

All day to day investment decisions have been delegated to a number of authorised investment managers. The strategic benchmark is reflected in the choice and mix of funds in which the Fund invests. The Fund’s benchmark is consistent with the Pensions Committee’s collective view on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk.

**Asset Allocation**

To achieve their objectives the Pensions Committee has agreed upon the following benchmark allocation:

| **Asset class** | **Current Allocation** | **Target allocation** |
|---|---|---|
| UK/Global Equity | 55% | 25% |
| Multi Asset strategies | - | 35% |
| Absolute Return strategies | 15% | 15% |
| Property | 10% | 5% |
| Gilts/Investment grade bonds | 20% | 17% |
| Infrastructure | 0% | 3% |

Equity allocations will be managed using a combination of active and passive strategies. All other allocations will be managed on an active basis. The multi asset strategies will be permitted to invest in a range of asset classes. However, it is not expected that the underlying asset allocation in these strategies will remain static over time.

The Committee has agreed to introduce an allocation to local infrastructure. The prospective investment is an amount of up to £15 million and based on 31 March 2013 levels would be rounded to 3%. Allocations to infrastructure will be introduced as opportunities are identified. Each opportunity will be funded through the payment of additional contributions to the Fund rather than by reallocating existing assets.
The underlying target return of this strategy over the next 10 years is at least the return on long dated index linked gilts plus 3.5% p.a, and allows for the expected returns from the asset classes plus a conservative allowance for performance for active manager skill.

**Choosing Investments**

The Pensions Committee has appointed investment managers who are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The Pensions Committee have given the investment managers specific directions as to the asset allocation but investment choice has been delegated to these managers subject to their respective benchmarks and asset guidelines. The allocation of assets to each manager is as follows:

| Mandate | % of current allocation | % of target allocation | Manager | Benchmark | Target |
|---|---|---|---|---|---|
| Property | 10% | 6% | UBS | IPD All balanced (property) Fund's median | To outperform the benchmark |
| UK Equities (Active) | 17% | *TBD | Standard Life | FTSE All Share | +2% net of fees |
| Global Equities (Active) | 17% | *TBD | Baillie Gifford | MSCI All Countries Index | +2.5% net of fees |
| Global Equities (Passive) | 21% | *TBD | State Street Global Assets | Composite | To track the benchmark (gross of fees) |
| Investment grade bonds | 20% | 19% | Royal London Asset Management | Composite | +0.75% net of fees |
| Absolute Return | 15% | 15% | Ruffer | UK bank deposit rate | To outperform the benchmark (net of fees) |
| Multi asset | | 34% | *TBD | *TBD | *TBD |
| Infrastructure | | 3% | *TBD | *TBD | *TBD |

*TBD (To be decided) this will be completed after the selection of the multi-asset managers and once the committee have confirmed the target allocations.

From time-to-time, particularly when implementing the changes to the strategic asset allocation, when markets are volatile or when dealing costs are high, the Committee may deviate from the long-term strategy on a temporary basis.

The Committee recognises that, while it is impossible to predict short-term market movements, it should use its reasonable judgement in such circumstances. For example, this could be applied with the aim of avoiding excessive dealing costs or reducing the impact of adverse market movements by spreading changes over a number of dealing dates. In doing so, the Committee also recognises that the Fund is intended to meet the liabilities as they emerge over the longer term and hence the normal default position is to be fully invested broadly in line with the strategic benchmark.

**Fees**

UBS is remunerated by a fixed management fee and the expenses inherent in the management of the pooled property fund. All other fund managers are remunerated by an ad valorem scaled fee based on the market value at quarter end of the assets under management.

**Investment Responsibilities**

**Responsibilities of the Pensions Committee**

- Overall investment strategy and strategic asset allocation with regard to the suitability and diversification of investments;
- Monitoring compliance with this Statement of Investment Principles and reviewing its contents;
- Appointing investment managers, an independent custodian, the Fund actuary, external independent advisers and investment adviser;
- Reviewing investment manager performance against established benchmarks on a regular basis;
- Reviewing the investment managers' expertise and the quality and sustainability of their investment process, procedures, risk management, internal controls and key personnel;
- Reviewing policy on social environmental and ethical matters and on the exercise of rights, including voting rights;
- Reviewing the investments over which they retain control and to obtaining written advice about them regularly from the investment adviser. The Pensions Committee will also obtain written advice from the investment adviser when deciding whether or not to make any new investments or to transfer or redistribute assets within the mandates, whether due to market movements or other factors;
- Rebalancing the assets with reference to trigger points. When the Fund allocation deviates by 5% or more from the strategic allocation, the assets will be rebalanced back to within 2.5% of the strategic asset allocation. In exceptional circumstances, when markets are volatile or when dealing costs are unusually high, the Committee may decide to suspend rebalancing temporarily. The priority order for funding rebalancing is to first use surplus cash, followed by dividend and or interest income and lastly using sales of overweighed assets. The Pensions Committee will seek the written advice of the investment adviser with regard to rebalancing and detailed distribution of cash or sale proceeds.

**The Pensions Committee is advised by The Council's Executive Officers, who are responsible for:**

- Ensuring compliance with statutory requirements and the investment principles set out in this document and reporting any breaches to the Pensions Committee;
- Management of surplus cash, which is lent through the money markets in accordance with the Council's Treasury Management Code of Practice. Performance is measured against the 7-day London Interbank Bid (LIBID) rate;
- Investment accounting and preparing the annual report and accounts of the fund;
- Ensuring proper resources are available for the Council's responsibilities to be met.

**The Investment Managers are responsible for:**

- The investment of pension fund assets in compliance with the legislation and the detailed investment management agreements;
- Tactical asset allocation around the managers' strategic benchmark as set by the Pensions Committee;
- Stock selection within asset classes;
- Voting shares in accordance with agreed policy;
- Preparation of quarterly reporting including a review of past investment performance, transaction costs and future investment strategy in the short and long term;
- Attending meetings of the Pensions Committee and officers of the council as required.

**The Independent Custodian is responsible for:**

- Provision of monthly accounting data summarising details of all investment transactions during the period;
- Providing investment transaction details in a timely manner to the independent performance measurers;
- Safe custody and settlement of all investment transactions, collection of income, withholding tax reclaims and the administration of corporate actions;
- The separation of investment management from custody is paramount for the security of the assets of the Fund.

**The Actuary is responsible for:**

- Undertaking a triennial valuation of the Fund's assets and liabilities and interim valuations as required, including those to enable compliance with the reporting standard FRS17/IAS19;
- Advising on the rate of employer contributions required to maintain appropriate funding levels;

- Providing advice on the admission and withdrawal of employers to the scheme, including external employers following externalisation of services;
- Preparing the Funding Strategy Statement.

**The Independent Measurers are responsible for:**

- Providing the Pensions Committee and the Council's executive officers with comparative information on the Fund's performance relative to other funds and the relative performance of different types of investments.

**The Investment Adviser is responsible for:**

- Advising on the investment strategy of the fund and its implementation;
- Advising on the selection of investment managers, and the custodian;
- Providing investment information, investment advice[1] and continuing education to the Pensions Committee and the executive officers;
- Independent monitoring of the investment managers and their activities.

The Investment Adviser is remunerated by way of time cost fees and fixed fees within an agreed annual budget.

**The Auditor**

- The Fund is audited annually by the auditors appointed by the Audit Commission. The financial year end is 31st March.

**The Historic Position of Fund**

The Fund is unlikely to be fully funded for several years. This has arisen for a number of reasons including:

- The reduction in the funding level to 75% of liabilities as a result of government regulations prior to the introduction of the community charge:
- The cost of the redundancy programme in the mid 1990's. *(Note that since 1998 redundancies and early retirements are a charge on departmental cost centres and external employers rather than the Pension Fund).*
- Overall investment returns since 1998 falling short of those anticipated in the funding strategy adopted from time to time.
- Longevity improving at a faster rate than anticipated.

At the last triennial valuation (at 31st March 2010) the funding ratio was 61%.

The Administering Authority is obliged to prepare a Funding Strategy Statement (FSS), which is published on the Council's web site at www.havering.gov.uk (select Services select 'Council and Democracy', select Pension Fund). This outlines the method by which the Fund aims to return to an acceptable level of funding. This is expected to be achieved by a combination of increased contributions to the Fund, and achieving good long-

[1] The Investment Adviser is authorised by and registered with the Financial Services Authority for the provision of investment advice.

term investment returns following the implementation of the new investment strategy in 2012

**Review**

- The investment strategy is reviewed by the Pensions Committee, at least every three years following the actuarial valuation results or when changes are required.
- The current review is based on the Actuarial Valuation 2010, a subsequent interim assessment of the valuation in 2012 and a review and on-going advice on asset allocation from the Fund's Investment Adviser during 2012.

**Reporting**

The investment performance of the individual managers is reported to the Pensions Committee and Officers quarterly. Reports are received from the fund's performance measurers and investment advisers, along with executive summaries from each investment manager including details of any voting undertaken in that quarter.

**Risk**

The Fund is exposed to a number of risks which pose a threat to the Fund meeting its objectives. The principal risks affecting the Fund are:

<u>Funding risks</u>**:**

- Financial mismatch – 1. The risk that Fund assets fail to grow in line with the developing cost of meeting Fund liabilities. 2. The risk that unexpected inflation increases the pension and benefit payments and the Fund assets do not grow fast enough to meet the increased cost.
- Changing demographics –The risk that longevity improves at a rate faster than that assumed and other demographic factors change increasing the cost of Fund benefits.
- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting Fund liabilities.

The Committee measures and manages financial mismatch in two ways. As indicated above, it has set a strategic asset allocation benchmark for the Fund. It assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark.

In 2012, following the 2010 Actuarial Valuation and a full review of investment strategy commissioned from the Fund's investment adviser, the Pension Committee agreed to revise the investment strategy. The underlying allocation to growth assets following the review is: 80% in a mixture of equities, property and alternative assets/strategies with the remaining 20% in lower volatility bonds. Although this is not in line with a liability-matched position, it is intended to grow the value of the assets at a managed level of risk with manageable long-term costs for the Council.

The Committee keeps under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration - The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

The Committee manages asset risks as follows:

It provides a practical constraint on Fund investments deviating greatly from the intended approach by setting itself diversification guidelines and by investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrains risk within the Committees' expected parameters.

The use of multi-asset and absolute return mandates recognises the expectation that risk will vary over time. By permitting the investment manager to not only invest in a diverse range of asset classes, but to vary the underlying asset distribution as market conditions change, the Committee expects that the pattern of returns will be smoothed.

By investing across a range of assets, including quoted equities and bonds; the Committee has recognised the need for some access to liquidity in the short term.

In appointing several investment managers and making appropriate use of passive management, the Committee has considered the risk of underperformance by any single investment manager.

Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee takes professional advice and considers the appointment of specialist transition managers.

- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers and audit of the operations they conduct for the Fund.

**Investments**

The powers and duties of the Fund to invest monies are set out in the Local Government Pension Scheme (Management & Investment Funds) Regulations 1998. The Fund is required to invest any monies which are not required to pay pensions and other benefits and in so doing take account of the need for suitable diversified portfolio investments and the advice of persons properly qualified (including officers) on investment matters.

**Types of Investment**

In broad terms investments may be made in accordance with the investment regulations in equities, fixed interest and other bonds and property and in the UK and overseas markets. The regulations specify other investment instruments may be used e.g. financial futures, traded options, insurance contracts, stock lending, sub-underwriting contracts, although historically it has not been the practice of the Fund to participate in these. Any limitations on the use of these instruments will be included within the Investment Management Agreements (IMA's) or equivalent pooled fund rules.

The investment regulations also specify certain limitations on investments.

The Pensions Committee has set out control ranges and restrictions for the Fund's investments. These control ranges and restrictions have been considered when setting the benchmarks for each Manager.

**Investment Management**

The Investment Managers are each bound by either an Investment Management Agreement (IMA) or, in the case of investment in pooled funds, the relevant Fund Documentation that takes account of:

- The benchmark set, and the allocation of assets within this benchmark;
- Cash needs;
- Risk tolerances;
- The policies on Corporate Governance and Socially Responsible Investment, given later in this document.

  The Investment Manager must also select the appropriate types of investment as defined in the Regulations.

**Investment Manager Controls**

The Investment Managers are authorised and regulated by the Financial Services Authority (FSA), and must comply with the regulations contained within the Financial Services and Markets Act 2000 (FSMA 2000). Under these regulations, the manager must ensure that suitable internal operating procedures and risk frameworks are in place. FSMA is designed to provide a Fund such as this with an adequate level of protection, and the Investment Managers are obliged to meet their obligation imposed by this act.

The mandates set for the Investment Managers contain controls to ensure compliance with best practice and regulations. Controls on cash levels and transfers of cash and assets are also set within the IMA's or equivalent pooled fund rules.

**Social Environmental and Ethical Considerations**

'The Pensions Committee has considered socially responsible investment in the context of its legal and fiduciary duties, and the view has been taken that, while the non-financial factors should not drive the investment process to the detriment of the financial return of the Fund, it is appropriate for the Investment Manager to take such factors into account when considering particular investments.

Over the longer term, the Pensions Committee requires the Investment Manager(s) to consider, as part of the investment decisions, socially responsible investment issues and the potential impact on investment performance. Beyond this, the Investment Manager(s) has full discretion with the day to day decision making.'

**Corporate Governance and Voting Policy**

**Corporate Governance Policy**

**'**The policy of the Havering Pension Fund is to accept the principles laid down in the Combined Code as interpreted by the Institutional Shareholders Committee 'Statement of Principles'.

In making investment decisions the Council will, through its Pension Fund Investment Manager(s), have regard to the economic interests of the Pension Fund as paramount and as such

1. Will vote at all general meetings of UK companies in which the Fund is directly invested.
2. Will vote in favour of proposals that enhance shareholder value.
3. Will enter into timely discussions with management on issues which may damage shareholders' rights or economic interests and if necessary to vote against the proposal.
4. Will take a view on the appropriateness of the structure of the boards of companies in which the Fund invests.

5. Will take a view on the appropriateness of the remuneration scheme in place for the directors of the company in which the Fund invests

Beyond this, the Council will allow its Investment Manager(s) full freedom with the day to day decision making.

The Pensions Committee will, where appropriate,

6. Receive quarterly information from the Investment Manager, detailing the voting history of the Investment Manager on contentious issues.
7. Consider a sample of all votes cast to ensure they are in accordance with the policy and determine any Corporate Governance issues arising.
8. Receive quarterly information from the Investment Manager, detailing new investments made.'

**Stock Lending**

The Committee has considered its approach to stock lending, taking advice from its investment adviser. After consideration of that advice, the Committee has decided only to permit stock lending by the Fund's passive equity manager, State Street.

State Street has agreed to indemnify the Fund against any loss arising from insufficient collateral being posted as part of its stock lending programme.

The Committee will review its policy on stock lending from time to time.

**Consultation and Publication**

The Council has reviewed the Statement of Investment Principles in association with the Fund's Investment Adviser and has also consulted with the employers of the fund, employee representatives and all fund managers through written correspondence.

A copy of this document together with the Myner's Statement of Compliance has been published on the Council's website www.havering.go.uk (select Services, select Council and Democracy, select Pension fund).

The Statement of Investment Principles will be reviewed at least annually and a revised version issued as soon as any significant change occurs. Any comments and suggestions will be considered. Please contact the Pension Fund Accountant with your views at info@havering.gov.uk .

**MYNERS Principles for Investment Decision Making**

The Pensions Committee will regularly review the Scheme's compliance with this Statement of Investment Principles.

The Action the Council has taken to meet the recommendations made in the Myner's report has been updated to March 2013 and is available as an appendix to this statement.

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Havering
LONDON BOROUGH

| PENSIONS COMMITTEE<br>24 July 2013 | REPORT |
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| | |
|---|---|
| **Subject Heading:** | **Local Government Pension Scheme – discussion paper on new Governance arrangement** |
| **CMT Lead** | **Andrew Blake-Herbert** |
| **Report Author and contact details:** | Debbie Ford<br>Pension Fund Accountant<br>01708 432569<br>Debbie.ford@havering.gov.uk |
| **Policy context:** | Governance arrangements under the new Public Service Pensions Act 2013 |
| **Financial summary:** | There are no direct implications arising from the discussion paper |

**The subject matter of this report deals with the following Council Objectives**

| | |
|---|---|
| Clean, safe and green borough | [] |
| Excellence in education and learning | [] |
| Opportunities for all through economic, social and cultural activity | [] |
| Value and enhance the life of every individual | [x] |
| High customer satisfaction and a stable council tax | [x] |

## SUMMARY

To inform the Committee of a discussion paper, issued by the Department for Communities and Local Government (DCLG), covering the new proposed governance arrangements for the Local Government Pension scheme (LGPS).

Feedback from the responses to the 26 questions within the discussion paper will be used to enable work on the preparation of the formal consultation later in the year.

Deadline for responses is the 30 August 2013.

## RECOMMENDATIONS

The Committee is asked to

- Consider the proposed new governance arrangements for the LGPS.
- Note the proposed questions, and
- Agree that member's delegate the approval of the Council's response to the Chair of the Pensions Committee.

## REPORT DETAIL

The Public Service Pensions Act 2013 includes several key provisions relating to the administration and governance of the new public service pension schemes established under Section 1 of the Act. In the case of the LGPS, these arrangements will apply to the new scheme which comes into effect on 1 April 2014.

The DCLG have subsequently mentioned that the governance part of the new LGPS scheme will be implemented after the 1 April 2014 but during 2014/15.

The discussion paper covers five specific sections of the act which impact on the governance arrangements in the new scheme, as follows:

- Part 1 - Responsible authority
- Part 2 - Scheme Manager
- Part 3 - Pension board
- Part 4 - Pension board information, and
- Part 5 - Scheme advisory board

The DCLG have issued the discussion paper, as **Appendix A,** with the aim of using the feedback to the 26 questions to enable work on preparation of the formal consultation later in the year.

## IMPLICATIONS AND RISKS

**Financial Implications and risks:**

There are no immediate financial implications arising from responding to the discussion paper. However, within the paper the DCLG mention that if the scheme advisory board is to undertake its full range of duties effectively, the annual cost of administration is likely to be significant. It has been estimated that this cost would be in the region of an additional £3k to £5k per annum.

The costs would be chargeable to the Pension Fund.

**Legal Implications and risks:**

There are no direct legal implications from the consideration of the issues raised in the consultation paper but, depending on the final structure of the revised scheme and its management, there may be implications for the Council in the relationship that will be created between the Pensions Committee and the new Local Pensions board.

**Human Resources Implications and risks:**

None arising directly from the discussion paper.

**Equalities implications and risks:**

None arising directly from the discussion paper.

## BACKGROUND PAPERS

DCLG LGPS (England and Wales) new governance arrangements – June 2013

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Department for
Communities and
Local Government

# Local Government Pension Scheme (England and Wales) new governance arrangements

## Discussion paper

June 2013
Department for Communities and Local Government

This document/publication is also available on our website at www.gov.uk/dclg

If you have any enquiries regarding this document/publication, email contactus@communities.gov.uk or write to us at:

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# Introduction

1.1 The Public Service Pensions Act 2013[1] includes several key provisions relating to the administration and governance of the new public service pension schemes established under Section 1 of the Act. In the case of the Local Government Pension Scheme in England and Wales, these arrangements will apply to the new Scheme which comes into effect on 1 April 2014.

1.2 This paper explores five specific sections of the Act which impact on the governance arrangements in the new Scheme :-

- Responsible authority
- Scheme manager
- Pension board
- Pension board information, and
- Scheme advisory board

1.3 Each section includes background and a more detailed summary of what we are required to include in the new Scheme to comply with the Act. Where appropriate, the paper also invites comment on consequential issues. Responses to the questions posed throughout the paper will enable us to start work on preparing draft regulations on governance for consultation later in the year.

## How to respond

1.4 You should respond to this discussion paper by **30 August 2013**.

1.5 You can respond by email to Philip.perry@communities.gsi.gov.uk

When responding please ensure you have the words "Scheme governance discussion paper" in the email subject line.

Alternately you can write to:

Scheme governance discussion paper
Department for Communities and Local Government
Zone 5/G6 Eland House
Bressenden Place
LONDON SW1E 5DU

1.6 When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please give a summary of the people and organisations it represents and, where relevant, who else you have consulted in reaching your conclusions.

[1] http://www.legislation.gov.uk/ukpga/2013/25/contents/enacted

## Timing

1.7 Although the Act requires the Secretary of State and scheme managers to establish a scheme advisory board and local pension boards respectively, there is nothing in the Act to say when these bodies are to become operational. This would appear to be a matter left for each individual scheme to consider and determine. We also know that the Pensions Regulator will not commence any of their formal duties or responsibilities under the Act until April 2015.

1.8 In overall terms, our clear priority is to ensure that we have a new Scheme in place so that pensions can continue to be accrued and paid from 1 April 2014 onwards. Between now and the end of the year, most, if not all, of our resources will need to be directed towards that aim, which leaves very little time to introduce new regulations on governance in time for the scheme advisory board and local pension boards to be operational with effect from 1 April 2014.

1.9 Our intention therefore, is to aim for the new governance regulations to be in place by April 2014, and for these to require the new national and local bodies to become operational later in the year. Between April 2014 and whenever the new scheme advisory board and local pension boards become operational, it is envisaged that existing governance arrangements under Section 101 of the Local Government Act 1972 will continue to apply.

**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?**

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

# Part 1 - “Responsible authority”

1.10 Section 2 of the Act, when read in conjunction with Schedule 2, provides that scheme regulations for local government workers (defined in Schedule 1 as “persons employed in local government service and specified in scheme regulations”) may be made by the Secretary of State. Under the Act, the Secretary of State has the title of “responsible authority”.

### Implementation

1.11 There is no requirement for us to establish the Secretary of State as the Scheme’s responsible authority in the new Scheme regulations. In that respect, Section 2 of the Act is self-standing. On first reading of the Act, it may appear that the Secretary of State’s regulation making power only covers local government workers. But the Act does provide for this to be extended by definition in the new Scheme regulations and the two consultation exercises on draft regulations commenced in December 2012 and March 2013 included such provision to ensure that regulations cover all members of the Scheme, including non-local government workers.

# Part 2 -“Scheme manager”

1.12 Section 4 of the Act requires the new Scheme regulations to provide for a person (“the scheme manager”) to be responsible for managing or administering the Scheme. The term “person” is not to be taken literally. For example, in a centrally administered scheme, Section 4(1) of the Act would allow the Secretary of State to be both the “responsible authority” and “scheme manager”. But in the locally administered Scheme, the “scheme manager” for the purposes of Section 4 will be each of the individual Scheme administering authorities in England and Wales.

1.13 Under Section 4(1)(b), the “scheme manager” is also responsible for managing or administering any statutory pension scheme that is connected with the main Scheme but section 4(4) provides that this does not include injury or compensation schemes.

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

## Implementation

1.14 In draft new Scheme regulations we are currently consulting on[2], Regulation 2(2) provides that the scheme manager responsible for the local administration of pensions and other benefits under the new Scheme regulations is to be referred to as the “administering authority”. We are satisfied that this is sufficient to comply with Section 4 of the Act.

1.15 Section 4(1)(b) of the Act extends the responsibilities of a scheme manager to include any statutory scheme connected with a main scheme. We are unaware of any such scheme that is connected to the Local Government Pension Scheme but invite consultees to tell us otherwise. As noted above, injury or compensation schemes are excluded by virtue of Section 4(4) of the Act.

**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?**

[2] https://www.gov.uk/government/organisations/department-for-communities-and-local-government/series/local-government-pensions

# Part 3 - “Pension board”

1.16 Section 5 of the Act requires the new Scheme regulations to provide for the establishment of a board with responsibility for assisting the scheme manager, or each scheme manager, in :-

a) securing compliance with the scheme regulations and other legislation relating to the governance and administration of the scheme and any statutory pension scheme connected with it;

b) securing compliance with requirements imposed in relation to the scheme and any connected scheme by the Pensions Regulator, and

c) such other matters as the scheme regulations may specify.

1.17 In making these regulations, the Department, as the “responsible authority”, must have regard to the desirability of securing the effective and efficient governance and administration of the Scheme and any connected schemes.

1.18 Our regulations will also need to include provision requiring each scheme manager to be satisfied that a person to be appointed as a member of a pension board does not have a conflict of interest, either at the outset, or from time to time. Section 5(5) of the Act defines “conflict of interest” 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.

1.19 Scheme regulations will also need to require any person appointed to the pension board or proposed to be appointed, to provide information that can reasonably be requested by the scheme manager to determine whether or not a conflict of interest exists.

1.20 By virtue of Section 5(4)(c), the regulations will also need to ensure that each pension board includes employer representatives and member representatives in equal numbers. Under the Act “employer representatives” means persons appointed to the board for the purpose of representing employers for the Scheme and “member representatives” means persons appointed to the board for the purpose of representing members of the Scheme. In this respect, it is noted that the Act permits nominations for scheme member representatives to come from trades unions or from members who are not members of trades unions.

1.21 Under Section 5(7) of the Act, where the scheme manager is a committee of a local authority, Scheme regulations may provide for that committee also to be the board for the purposes of Section 5.

## Implementation

1.22 It is clear that the new Scheme regulations will need to require each scheme manager/administering authority to establish their own pension board. To comply with Section 5 of the Act, the new Scheme regulations will need to include :-

- The role of each pension board 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.

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

- 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 (see paragraph 1.18 above) and also to undertake regular checks;

**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?**

- 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.

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

- A requirement that each pension board must include employer representatives and member representatives in equal numbers.

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

1.23 In addition to the above requirements imposed on the new Scheme by the Act, there are many other issues that we will need to address in preparing draft regulations for consultation. These include :-

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

1.24 Section 5(7) of the Act would allow the new Scheme regulations to permit a committee of a local authority to also be the local pension board. This option was deliberately left open in the Act to ensure that a proper discussion of the issues with all interested parties could be undertaken.

1.25 The argument for and against separate bodies is finely balanced. Those who support the committee and pension board being one and the same body argue that local government cannot afford to spend more time and money setting up new bodies, particularly when the function could easily be undertaken by existing pension or investment committees. Others argue that a statutory decision making committee is in no position to fulfil the clear scrutiny role set out in the Act. It cannot, in effect, scrutinise itself and be in a position to assure the scheme manager that it is complying with all relevant legislation and Pension Regulator's codes of practice.

1.26 A further consideration is that combining a statutory committee with a pension board would, by virtue of Section 5(4)(c) of the Act, require the combined body to have equal numbers of employer and scheme member representatives.

1.27 Although we are seeking your views on the status of local pension boards and statutory committees, the Department is clear that the final outcome must be applied consistently across the Scheme as a whole. We do not therefore contemplate giving individual scheme managers/administering authorities the same choice afforded to us by the Act. All pension boards will either be combined or separated from statutory committees.

1.28 If the new Scheme regulations were to require local pension boards to be separate from any statutory committee, we would certainly encourage scheme managers/administering authorities to use existing non-statutory bodies to take on or adapt to the role of the new pension boards, but bearing in mind that the requirement to have equal number of employer and scheme member representatives would still apply.

**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?**

## Level of prescription

1.29 Paragraph 1.22 above sets out the provisions of the Act that we must carry forward into the new Scheme. Apart from requiring equal numbers of employer and scheme member representatives and the restriction on conflicts of interest, the Act is silent on key issues including, for example, membership, constitution, frequency of meetings, the nomination process and training. In responding to Questions 10 and 11 below, it would be helpful if you could set out any particular views you might have on how the nomination process should operate.

1.30 As a general rule, the Department's preference would be to leave as much of the detailed workings of local pension boards as possible for determination at local level.

**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?**

## Restrictions on membership

1.31 In early discussions with interested parties, concerns were expressed that scheme managers/administering authorities may look for savings by moving any scheme member representative from their statutory committee to their pension board (if the committee and the board are not one and the same body).

**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)?**

### Annual report

1.32 Under Section 6(1) of the Act, Scheme regulations will need to require scheme managers/administering authorities to publish certain membership details of their local pension board. Given that the main function of the board will be to assure the scheme manager/administering authority that those to whom they have delegated the pensions function to are complying with legislation and codes of practice, there is a case for the new Scheme regulations to also require each board to publish an annual report summarising its work.

**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

1.33 Paragraph 14 of Schedule 4 of the Act amends Section 90 of The Pensions Act 2004 and requires the Pensions Regulator to issue various codes of practice, including one on the requirements for knowledge and understanding of members appointed to pension boards of public service pension schemes. The Department, together with other interested parties, will be consulted on the content of this and other codes of practice and this ought to be sufficient to ensure that the specific circumstances of the Local Government Pension Scheme and the role of new local pension boards can be taken into account.

**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?**

# Part 4 – Pension board – information

### Implementation

1.34 Scheme regulations will need to include provision for each scheme manager to publish information about the pension board and to keep that information up to date. This information includes who the members of the board are; representation on the board of members of the scheme and the matters falling within the board's responsibility.

# Part 5 – “Scheme advisory board”

1.35 Section 7(1) of the Act will require Scheme regulations to provide for the establishment of a board with responsibility for providing advice to the Secretary of State, at the Secretary of State’s request, on the desirability of changes to the Scheme.

1.36 For locally administered schemes like the Local Government Pension Scheme where there is more than one scheme manager, Scheme regulations may also provide for the board to provide advice (on request or otherwise) to the scheme managers or the scheme’s pension boards, in relation to the effective and efficient administration and management of the Scheme or any pension fund of the Scheme.

1.37 Under Section 7(4), Scheme regulations will need to apply the same provisions relating to conflicts of interest to the scheme advisory board as described at paragraph 1.18 above, except that it will be for the Secretary of State to consider and act on actual cases.

### Implementation

### Scope/role

1.38 Section 7(1) of the Act defines the scope and role of the scheme advisory board in the widest possible terms (see paragraph 1.35 above). Replicating the wording of the Act in Scheme regulations would be advantageous in terms of allowing the work of the scheme advisory board to evolve without the need for regulatory amendments, but equally, there may be merit in clearly defining certain areas of work, for example, making recommendations to the Secretary of State on cost management proposals.

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

1.39 Section 7(1) of the Act provides that the scheme advisory board is responsible for providing advice to the Secretary of State, as the responsible authority, at the Secretary of State’s request. This would suggest that the board can only advise when asked to do so on a case by case basis by the Secretary of State. We have taken advice from HM Treasury who take a more lenient view and suggest that it would be in order for Scheme regulations to set out the terms on which advice may be given.

**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?**

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

## Membership

1.40 As Section 7 of the Act makes no provision for membership of the scheme advisory board, it will be for Scheme regulations to make such provision. This could be achieved in a number of different ways, for example :-

- The Secretary of State could appoint a small membership panel whose remit would be to nominate and appoint initial members of the board, including the Chairperson;
- As above, but Scheme regulations could also prescribe the sectors from which members of the board are to be drawn;
- The membership profile of the shadow scheme advisory board could be carried forward.

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

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

**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?**

**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?**

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

**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?**

**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?**

## Funding

1.41 If the scheme advisory board is to undertake its full range of duties effectively, the annual cost of administration is likely to be significant. It has been estimated that this may be in the region of an additional £3k per annum per fund, or £5k if project work is also to be included rather than as a separate cost to be levied. In early discussions with the shadow scheme advisory board it has been made clear that both it and the scheme advisory board must be self financing.

1.42 In terms of funding there would appear to be two clear alternatives. Funding the board could be achieved either by voluntary subscription or a mandatory levy from scheme managers/administering authorities. A clear risk associated with a voluntary subscription is that the board's agenda and workplans would be subject to an uncertain level of funding, dependent on whether or not individual fund authorities considered the work of the board to represent good value for money. However, a mandatory levy would give the board the financial certainty that it would need to be able to discharge its functions and could be justified on the grounds that it is advising the Secretary of State and assisting local pension boards on behalf of the Scheme as a whole. In either case, we envisage that the cost would be regarded as an administration cost and therefore rechargeable to the fund.

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

### Constitution

1.43 The Act requires the setting up of the scheme advisory board but not the manner of its legal constitution. This would imply some form of body corporate to be set out in scheme regulations. Beyond setting out the corporate status of the board, scheme regulations would also need to spell out the personal liability protection for board members.

**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?**

# Conclusion

1.44 Significant steps have been taken in the past to improve Scheme governance and, in particular, to ensure the effective representation of Scheme beneficiaries. Ministers have consistently remarked on the importance of good Scheme governance and the Public Service pensions Act now provides us with the opportunity to build on this earlier success. We would strongly encourage you to consider this paper carefully and to respond to as many of the questions as you see fit. Your contribution will be of great assistance in helping us to prepare a set of draft regulations on Scheme governance for formal consultation later in the year.

# List of questions

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?

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

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?

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

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?

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

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

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?

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?

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)?

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?

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?

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

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?

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

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