

**JOHN RAISIN FINANCIAL SERVICES LIMITED**

**Haringey Pension Fund**

**LGPS Update**

**A paper by the Independent Advisor**  
**January 2020**

**Introduction**

The purpose of this paper is to update the Pensions Committee and Board on a number of major developments in the Local Government Pension Scheme (LGPS). This paper does not seek to address every significant issue relevant to the LGPS but focusses on four issues:

- Good Governance in the LGPS project, particularly the Phase II report
- Updating of Knowledge and Skills requirements (Update of CIPFA frameworks etc)
- The Pension Regulator's report on Governance and Administration in the LGPS
- The Scheme Advisory Board (SAB) and Responsible Investment

**1. Good Governance in the LGPS project**

**Background**

As reported in previous papers (Pensions Committee and Board, 21 January 2019, Item 10, Appendix 1; Pensions Committee and Board, 11 July 2019, Item 12, Appendix 1; and Pensions Committee and Board 19 September 2019, Item 10, Appendix 1) the Scheme Advisory Board (SAB) invited proposals from interested parties to assist it in developing options for change with regard to the relationship of LGPS Pension Funds to their existing host authorities. Hymans Robertson were awarded the contract to work with the SAB and completed work leading to a report to the SAB the final version of which was released on 31 July 2019.

In their July 2019 report Hymans Robertson did not suggest any structural change in relation to the number of LGPS Funds in England and Wales (87 at the time this report was issued) but rather *“informed by feedback from stakeholders”* made four proposals for consideration by the SAB also stating *“many are things which well-run funds already do.”* The proposals were:

1. **‘Outcomes-based’ approach** to LGPS governance with minimum standards rather than a prescribed governance structure.
2. **Critical features of the ‘outcomes based’ model** to include:
  - a. Robust conflict management including clarity on roles and responsibilities for decision making.
  - b. Assurance on sufficiency of administration and other resources (quantity and competency) and appropriate budget.
  - c. Explanation of policy on employer and scheme member engagement and representation in governance.
  - d. Regular independent review of governance.
3. **Enhanced training requirements** for Section 151 (Chief Finance Officers) and Section 101 (Pension) Committee members with training requirements for Pension Committee members on a par with Local Pension Board members.
4. **Update relevant guidance and better sign-posting** including suggestions that CIPFA review and update guidance for Section 151 (Chief Finance) Officers in respect of LGPS governance and that the MHCLG review and update Statutory Guidance on LGPS governance issued in 2008.

The Board meeting of the SAB held on 8 July 2019 agreed that the SAB Secretariat (Officers) should in liaison with the project team from Hymans Robertson and Scheme stakeholders develop a detailed plan to implement the conclusions from the Hymans Robertson report for presentation to the November meeting of the SAB. Two stakeholder working groups were to be established to take forward the Hymans Robertson proposals.

The Standards and Outcomes Workstream focussed on specifying clearly the outcomes and standards to be achieved by LGPS Funds under the proposed new governance approach. The Compliance and Improvement Workstream focussed on the compliance arrangements to independently assess LGPS Funds against the new governance approach. The working groups comprised a total of 20 representatives from a diverse range of stakeholders supported by 4 Hymans Robertson representatives. A report by both workstreams and Hymans Robertson, including detailed implementation proposals was considered by the SAB and issued in November 2019.

## Overview of the “Good governance in the LGPS Phase II report”

The Good governance in the LGPS Phase II report contains the proposals of both the Standards and Outcomes, and the Compliance and Improvement Workstreams to take forward the proposals contained in the “Good governance in the LGPS” report of July 2019. The preparation of the Phase II report included two full days of meetings, in London. On the first day, in September, the Standards and Outcomes Workstream met in the morning and the Compliance and Improvement Workstream in the afternoon. On the second day, in October, both Workstreams met together for a whole day. Hymans Robertson facilitated and provided revised draft documentation throughout the process. Following the second day of meetings in October a further draft report was prepared by Hymans Robertson and Workstream members given 10 days to make any further comments. The final Phase II report was issued to members of the Scheme Advisory Board in late October ahead of their meeting on 6 November 2020.

### Workstream 1 Standards and Outcomes

The Standards and Outcomes Workstream made observations and recommendations in respect of the following issues: *General* (overall governance issues), *Conflicts of interest*, *Representation*, *Skills and training*, *Service delivery for the LGPS function*.

#### General:

In order to seek to ensure the actual implementation of, and compliance with, the proposed new governance arrangements across the entire LGPS in England and Wales the report states (page 2) that *“It is envisaged that all the proposals made in this document will be enacted via the introduction of new statutory governance guidance.....”* The recommendation (A.1) that MHCLG *“produce statutory guidance to establish new governance requirements for funds to effectively implement the proposals”* in the report is absolutely essential if the new LGPS governance arrangements arising from the Good governance in the LGPS project are to be compulsory on all LGPS Funds across England and Wales.

To further enhance Fund governance the report proposes (page 2) that *“each administering authority must have a single named officer who is responsible for the delivery of the pension function. (“the LGPS senior officer”). This may be the S151 officer, assuming they have the capacity, LGPS knowledge and internal assurance framework to assume that role. Alternatively, the LGPS senior officer role may be undertaken by another officer who has the remit of delivering the LGPS function in its entirety and who is likewise suitably qualified and experienced and has the capacity to assume this role. This should be a person close enough to the running of the fund that they have sight of all aspects of the fund’s business. The role of the responsible person should be assigned through the host authority’s scheme of delegation and constitution....”*

This statement and the accompanying recommendation (A.2) are particularly important in terms of seeking to ensure the proper oversight of each LGPS Fund by a single officer. This would, for example, end the practice of some Administering Authorities where the LGPS Investment and Pensions Administration functions ultimately report to separate Chief Officers. Perhaps most fundamentally, however, this proposal seeks to ensure a clear focus on the LGPS through the designation by the Council (in its Constitution) of a named single officer *“responsible for the delivery of all LGPS related activity.”*

The proposal seeks to ensure that the single named officer is genuinely involved in, and both capable of and willing to oversee the LGPS function in its entirety. While the proposal is clear that the single named officer *“may be”* the Council’s Section 151 Officer it is also very clear that this may not necessarily be the appropriate approach and that the designation of *“the LGPS senior officer”* should be a matter determined by full Council. Where the LGPS senior officer is not the S151 Officer that officer would, of course, retain their statutory financial responsibilities relating to the Pension Fund just as they do for other services, such as Adult Social Care, where they are not actually responsible for the delivery of that service themselves.

The report proposes (page 2) that each LGPS Fund *“must produce an enhanced annual governance compliance statement”* also recommends (A.3) that *“Each administering authority must publish an annual governance compliance statement that sets out how they comply with the governance requirements for LGPS funds as set out in the [MHCLG] guidance.”* This enhanced Governance Compliance Statement will be examined as part of the regular Independent Governance Review the details of which are proposed later in the Phase II report.

The recommendations in relation to new Statutory Guidance, the *“LGPS senior officer”* and the enhanced Governance Compliance statement should hopefully ensure that the remainder of the proposals/recommendations in the Good governance in the LGPS Phase II report are actually and positively implemented across all LGPS Funds in England and Wales.

Conflicts of interest:

This section while addressing the matter of Conflicts of interest generally particularly seeks to ensure that the issue of potential Conflicts of interest involving the Council and/or the Fund are clearly addressed. Examples of such potential conflicts listed in the Part II report (page 3) include:

- *Contribution setting for the AA [Administering Authority] and other employers*
- *Cross charging for services or shared resourcing between the AA and the Fund*
- *Local investment decisions*

The inclusion of potential Conflicts relating to the LGPS Fund and its interaction with the host Council and the local area further emphasises, and seeks to ensure, the practical separation of the activities of the Council as a whole and that of the Pension Fund. This is logical and appropriate as the LGPS Fund exists to provide pension benefits to individual members (employees) and their dependants and includes other employers than the Administering Authority and employees who do not/did not work for the Administering Authority.

#### Representation:

Recognising the fact that the LGPS includes other Employers than the Administering Authorities and that the LGPS exists to provide pension benefits to its individual members and their dependants the Phase II report (page 4), while recognising it is a matter for the Administering Authority as to who is appointed to any LGPS decision making body (usually the Pensions Committee), recommends (C.1) that *“Each fund must produce and publish a policy on the representation of scheme members and non-administering authority employers on its committees, explaining its approach to representation and voting rights for each party.”* Clearly this recommendation will require each Administering Authority to actively consider its policy on these matters and publicly explain it.

The section on representation also includes the statement that *“Best practice would suggest that scheme member representation in some form is a desirable goal for administering authorities.”* The Phase II report is also clear, however, as to the ultimate responsibility of the Administering Authority for the LGPS in their area commenting that the MHCLG *“Guidance should also acknowledge the important principle that administering authorities may wish to retain a majority vote on decision making bodies to reflect their statutory responsibilities for maintaining the fund.”*

#### Skills and Training:

The Phase II report (page 5) recommends (D.1) that both Pension Committee members and LGPS Officers should be subject, under the new MHCLG guidance, to a similar requirement to maintain knowledge and understanding as are Pension Board members. This is entirely logical and appropriate given Pension Boards (usually) do not have decision making powers but both Pension Committees and Officers do.

The Phase II report also includes a recommendation (D.2) that both Administering Authority and non Administering Authority S151 Officers be required by their professional body to *“carry out LGPS relevant training as part of their CPD requirements....”* Recommendation D.4 states *“CIPFA and other relevant professional bodies....be asked to produce.... training.... for s151 officers.....”* It is clearly absolutely essential that S151 Officers of Administering Authorities (whether or not they are designated as *“the LGPS*

*senior officer” have a clear knowledge and understanding of the LGPS. The proposed requirement that S151 Officers of non Administering Authorities also be required to obtain what the Phase II report describes as “A level of LGPS knowledge” is a very positive development in helping ensure other Employers engage actively and knowledgeably with their LGPS Fund and that misunderstandings are minimised.*

Recommendation D.3 seeks to ensure that LGPS Funds implement the enhanced training requirements by requiring them (D.3) to *“publish a policy setting out their approach to the delivery, assessment and recording of training plans.....”*

Service delivery for the LGPS function:

The Good governance in the LGPS (Phase I) report of July 2019 was clear that LGPS Funds should be able to evidence that their resource (both quantity and competency) is such that they can meet regulatory requirements and that their budget is such to facilitate this. The Phase II report (page 6) states that this resource requirement *“refers to all of the tasks and processes required to deliver the Scheme and is not limited to the calculation and payment of benefits. This definition encompasses a funds accountancy function, investment support, employer liaison, systems, communications etc.”* Clearly therefore LGPS Funds are expected to ensure they are properly resourced across the entire broad range of their functions and responsibilities.

In order to provide some measure of performance the Phase II report on page 7 (Recommendation E.3) proposes that *Each administering authority must report the fund’s performance against an agreed set of indicators designed to measure standards of service.”* The narrative in the report (page 6) suggests that *“A series of some 10 to 15 key indicators or measures of standards of LGPS service delivery to members and employers should be agreed....”*

A proper and sufficient budget based on a proper Fund Business Plan is clearly essential for the effective delivery of the LGPS function by each individual LGPS Fund. Therefore, the Phase II report narrative (page 6) includes a statement that each LGPS Fund (Administering Authority) should have its own budget and that this is *“set and managed separately from the expenditure of the host authority.”* The report narrative goes on to state *“Budgets for pension fund functions should be sufficient to meet all statutory requirements, the expectations of regulatory bodies and provide a good service to Scheme members and employers.”*

The narrative (page 6) also includes the statement that *“Required expenditure should be based on the fund’s business plan and deliverables for the forthcoming year. The practice should not simply be to uprate last year’s budget by an inflationary measure or specify an “available” budget and work back to what level of service that budget can deliver”*

The narrative (page 6) emphasises the role of the Pension Committee (and the Pension Board) with the statements *“The budget setting process should be initiated and managed by the fund’s officers and the pension committee and assisted by the local pension board”* and *“Typically this will involve the pension committee being satisfied that the proposed budget is appropriate to deliver the fund’s business plan.....”* Recommendation E.4 (page 7) places a clear responsibility on both the LGPS Senior Officer and the Pensions Committee for the sufficiency of resources to provide an effective LGPS service stating *“Each administering authority must ensure their committee is included in the business planning process. Both the committee and the LGPS senior officer must be satisfied with the resource and budget allocated to deliver the LGPS service over the next financial year.”*

The Good governance in the LGPS (Phase I) report of July 2019 (page 16) recognised the clear recruitment and retention issues facing those LGPS Funds seeking to provide a proper and effective service. The Phase I report included the statements that *“Administering authorities may need freedom to use market supplements to attract and retain staff and should not be tied to council staffing policies such as recruitment freezes”* and *“Many administering authorities already have pay and recruitment policies relevant to the needs of their pension function rather than being tied to the general policies of the Council.”*

The Phase II report further develops and reiterates the theme that the LGPS function should not be simply be treated in the same way as a General Fund function in relation to Human Resource policies and practices. Rather Human Resource policies and practices applied to the LGPS function should positively facilitate the delivery of the Pensions function. The Phase II report narrative (page 7) includes the statement *“Each Administering Authority has a duty to ensure that its pension function is staffed such as to enable it to deliver an effective pensions service to all the fund employers and members. It is therefore important that the recruitment and retention practices applied to the pensions function facilitate this. For example, the use of market supplements may be necessary to recruit/retain both investment and pensions administration staff. Further, given that the pension fund budget is set and managed separately from the expenditure of the host authority, the impact of general council staffing policies such as recruitment freezes should not be applied to the pension fund by default.”* The Phase II report includes a specific recommendation (E.5) on page 7 in respect Human Resource policies applicable to LGPS Funds stating *“Each Administering Authority must give proper consideration to the utilisation of pay and recruitment policies, including as appropriate market supplements, relevant to the needs of their pension function. Administering Authorities should not simply apply general council staffing policies such as recruitment freezes to the pensions function.”*

## Workstream 2 Compliance and Improvement

The Compliance and Improvement Workstream made observations and recommendations in respect of the arrangements for the regular independent review of LGPS Fund governance arrangements in the context of the requirements as set out in the proposed new Statutory Guidance to be issued by MHCLG (recommendation A.1 of the Standards and Outcomes Workstream) to implement the proposals made in the Phase II Good governance in the LGPS report.

Compliance and Improvement:

Workstream 2 recommended (F.1) on page 9 that *“Each administering authority must undergo a biennial Independent Governance Review and, if applicable, produce the required improvement plan to address any issues identified.”* Such an approach is essential if the proposals of the Standards and Outcomes Workstream are to be genuinely implemented across all LGPS Funds and both good and questionable practice identified and as appropriate responded to by the Scheme Advisory Board and MHCLG.

The narrative (on page 8) includes the following statement *“The new MHCLG guidance should set out a process for an Independent Governance Review....”* Amongst the features of this suggested in the Phase II report are:

- *“It will be mandatory for each Fund to commission an Independent Governance Review (“IGR”) which will audit the fund’s Governance Compliance Statement and review compliance with the requirement of the new statutory guidance”*
- *“There should be a standardised framework and process for IGRs...”*
- *“It is critical that the IGR should be conducted by appropriate persons who: properly understand the LGPS; are sufficiently at arm’s length from the .... pensions function....; are in some way “accredited to ensure consistent standards of review.”*
- A *“procurement framework”* be put in place for IGR suppliers
- *“.... Funds may appoint an external supplier”* from the framework
- Alternatively, an Administering Authority *“may choose to have their IGR carried out by their own internal audit or another appropriate party to the same standards as the framework.”*
- Each LGPS Fund *“should have an IGR completed biennially”*



- SAB may *“as a result of concerns”* direct that an Administering Authority *“must have”* an IGR *“outside of the two year cycle.”*
- Results of the IGR review will be reported to the LGPS Fund and Local Pension Board
- *“The Administering Authority must develop an improvement plan to address any issues raised in the IGR”*
- The IGR and improvement plan *“must be published and also be submitted to SAB.....”*
- *“SAB will put in place a panel of independent experts to scrutinise IGR reports, looking for outliers and areas of concern....”*
- *“The SAB panel may enter into discussions with funds.....  
Additionally, they may refer the unsatisfactory IGR to TPR or further escalate to MHCLG.”*
- *“Failure to submit an IGR report by the required date will result in automatic referral”*

The above narrative indicates that a robust compliance and improvement regime is to be implemented. Perhaps the only significant weakness is that the Phase II report proposes allowing LGPS Funds not to have to select an external supplier from the proposed framework but that an Administering Authority *“may choose to have their IGR carried out by their own internal audit or another appropriate party to the same standards as the framework.”* This caveat weakens the compliance and improvement proposal as internal audit services or *“another appropriate party”* may not necessarily have the knowledge and skills to properly undertake the IGR and may also possibly be considered not to be fully independent from the Administering Authority. The most robust approach to compliance and improvement is surely the selection of a supplier from the procurement framework proposed in the Phase II report narrative (page 8, section F.1. d & e) who has no current relationship with the Administering Authority.

The Compliance and Improvement Workstream made a second recommendation, on page 9, (F.2) that *“LGA to consider establishing a peer review process for LGPS Funds.”* As the narrative in the report indicates (page 9) an LGA (Local Government Association) peer review is requested by a Council and results in a small team of external Officers and Councillors *“spending time at the council as peers to provide challenge and share learning....”* The Phase II report suggests that *“a similar peer challenge process is established for the LGPS.”*

## Next Steps

The main body of the Good Governance in the LGPS Phase II report ends with a “Next steps” section (page 10). This states:

*“The Working Group recommends that SAB and MHCLG accept the recommendations in this report and initiate phase III of the project.”*

*“Phase III should contain the following elements:”*

1. *“MHCLG to draft the required changes to the Guidance.”*
2. *“SAB to ask the National Framework to begin work on establishing Independent Governance Review provider framework.”*
3. *“SAB to establish the 10-15 KPIs.... within proposal E.3.”*
4. *“It is envisaged that the governance compliance statement will act as a summary, evidencing the Fund’s position on all areas of governance and compliance.....”*

At the meeting of the SAB Board meeting held on 6 November 2019 it was determined that:

- The Good Governance Phase II report to be published
- The SAB Secretariat, with Hymans Robertson and stakeholders, should develop Phase III of the project including the draft Statutory Guidance and key performance indicators
- Comments on the Phase II recommendations be invited
- Final proposals for Phase III to be considered by the Board on 3 February 2020

## **2. Updating of Knowledge and Skills requirements (Update of CIPFA frameworks etc)**

It is clearly fundamental that those involved in the governance of the LGPS whether Officers, Pension Committee members or Pension Board members have the appropriate knowledge, understanding and skills to properly and effectively discharge their duties.

In 2010 CIPFA produced two *“Pensions Finance Knowledge and Skills”* frameworks - one for *“Elected Representatives and Non Executive Members”* (essentially Pension Committee members) and one for *“Pensions Practitioners”* (essentially Fund Officers). These were supplemented in 2013 by the *“Code of Practice on Public Sector Pensions Finance Knowledge and Skills.”* Together

these three publications presently form the basis of recommended Knowledge and Skills framework/approach for those involved in LGPS governance and decision making. These documents were supplemented in 2014 by a LGPS specific supplement to the CIPFA statement on the role of the Chief Finance Officer and in 2015 by “*A Technical Knowledge and Skills Framework*” for Local Pension Boards.

Given the main CIPFA guidance on Knowledge and Skills requirements pre dates the introduction of the present LGPS arrangements in 2014 and has not been updated to take account of developments since 2014 there is clearly an urgent need for a review. Therefore, CIPFA have initiated such a review utilising AON (one of the leading Investment Consultancy and Actuarial firms to the LGPS community) to undertake the detailed work.

The Agenda for this review includes review and amalgamation of existing guidance; expansion of the guidance; the application of the new guidance; consideration of delivery, monitoring, reporting and compliance. As part of the Knowledge and Skills revision exercise a number of other areas of guidance/development are been utilised/considered. These include not only CIPFA guidance/documents on issues including risk, investment pooling and the preparation of the Pension Fund Annual Report but MHCLG Statutory Guidance; the Scheme Advisory Board MiFID II opting up process/guidance; and The Pensions Regulator’s Code of Practice for Public Service Pension Schemes.

The Objectives of the Knowledge and Skills review may be summarised as:

- **Amalgamation** of guidance
- **Updating** of guidance to incorporate developments including investment Pooling and MiFID II
- **Clarification** of expected standards, including linkage to the SAB “Good governance in the LGPS” project expectations regarding training requirements for Pension Committee Members and Chief Finance (Section 151) Officers
- **Education** including through the provision of examples and ensuring a focus on decision makers and senior LGPS Fund Officers

The project to review the LGPS Pensions Knowledge and Skills arrangements commenced in the Autumn of 2019 and is expected to be concluded during the Spring of 2020. New guidance/frameworks will then be launched by CIPFA.

### **3. The Pension Regulator's report on Governance and Administration in the LGPS**

On 19 September 2019 The Pensions Regulator (TPR) published a report entitled ***“Governance and administration risks in public service pension schemes: an engagement report.”*** This report is concerned specifically with the LGPS. The report is based on TPR engagement with 10 local government funds across the UK, to understand approaches to a range of important risks.

The engagement occurred between October 2018 and July 2019. According to the report the review was based on meetings with LGPS Funds supplemented by review of some documentation and examples of communications sent to members, prospective members and beneficiaries.

The report contains **Findings, Recommendations and Case Studies** covering the following: Record Keeping; Internal Controls; Administrators; Member Communication; Internal Dispute Resolution Procedure; Pension Boards; Employers and Contributions; Cyber Security; Internal Frauds.

Below is a summary of the report under each topic heading:

#### **Record Keeping**

Fundamentally the record keeping section commences with the statement *“Failure to maintain complete and accurate records and put in place effective internal controls to achieve this can affect the ability of schemes to carry out basic functions.....”*

Findings: *“Many scheme managers have moved from annual to monthly member data collection.....Well-run funds are aware of the quality of the common and scheme specific data they hold.... They also generally have a robust PAS in place which detail rights and obligations of all parties to the fund.”*

Recommendations *“.... Data quality needs regular review. A robust data improvement plan should be implemented as appropriate. The quality of member data should be understood by the Scheme Manager and Pension Board.... An action plan should be implemented to address any poor data found.... The Pension Board should review the PAS and ensure it will stand up to challenges from employers.”*

#### **Internal Controls**

Findings: *“.... Some funds had detailed risk management frameworks in place.... Others lack detailed risk registers or do not review the risks to the fund on a frequent basis.....We found evidence.... of key person risk, where a long serving member of staff has developed a high level of knowledge... but this knowledge is not documented....”*

Recommendations: *“A risk register should be in place and cover all potential risk areas. It should be regularly reviewed by the pension board.... The pension board should have good oversight of the risks and review these at each pension board meeting. Internal controls and processes should be recorded, avoiding an over reliance on a single person’s knowledge levels.....”*

### Administrators

Findings: *“Better performing scheme managers have a close relationship with their administrator.... robust SLAs are in place which are routinely monitored by senior managers. These scheme managers are also willing to effectively challenge reports from administrators to ensure they fully understand the work being done.....”*

Recommendations: *“Scheme managers must agree targets and have a strong understanding of what service providers are expected to achieve.... It is helpful for the administrator to attend and present to pension board meetings as pension board members can use their knowledge and understanding to effectively challenge reports being provided.....”*

### Member Communication

Findings: *“.....It is widely appreciated that pensions and retirement provision is complicated, and communication with savers needs to be in plain English. A variety of methods are being used, with the strongest scheme managers in this area working closely with a technical team and also enlisting the assistance of non technical staff to check readability and whether it is comprehensive....”*

Recommendations: *“Information sent to members should be clear, precise and free from jargon.....It is often helpful for scheme managers to measure the effectiveness of their communication with savers, eg measuring website traffic and running surveys.”*

### Internal Dispute Resolution Procedure (IDRP)

Findings: *“Some scheme managers have clear procedures in place for recording, and learning from, complaints and disputes they receive.... Not all the complaints procedures and IDRPs we saw were clear about who was entitled to use them, and in some cases details of how to complain were not clearly published.....Not all scheme managers have a clear definition of a complaint.”*

Recommendations: *“There should be a clear internal policy on how to handle complaints.....People entitled to use the IDRP should be given clear information about how it operates. This information should be easily available, eg on the fund website. The pension board and scheme manager should have oversight of all complaints and outcomes, including those not dealt with in-house. Complaints and compliments could be analysed to identify changes that can be made to improve the operation of the fund.”*

## Pension Boards

The Haringey Fund along with the Hampshire Fund has a Joint Pensions Committee and Board unlike the other 84 LGPS Funds in England and Wales which have a separate Scheme Manager (usually the Pensions Committee) and Pensions Board. Therefore, most of the commentary on Pension Boards in the TPR report was not applicable to the Haringey Fund. However, the particular comments reproduced below are clearly relevant to Haringey

*Findings: "... where the pension board had a strong relationship with the scheme manager, including a willingness to challenge, we found better-run funds."*

*Recommendations: ".....Individual pension board member training and training needs should be assessed and clearly recorded...."*

## Employers and Contributions

*Findings: ".... Scheme managers have a variety of ways of assessing the risk of employers failing to pay contributions or having a disorderly exit from the fund, depending on the fund's resources. Better resourced and funded scheme managers will carry out detailed covenant assessments of all participating employers, with other scheme managers only reviewing those they believe to pose the highest risk. Most scheme managers seek security from employers to mitigate the risk of a failure to pay contributions.....Decisions around what security to require are often based on previous ways of operating, rather than considering the best option in individual circumstances."*

*Recommendations: "Scheme managers should understand the financial position of participating employers and take a risk-based and proportionate approach to identifying employers most at risk of failing to pay contributions.... Employer solvency should be considered on an ongoing basis and not just at the time of each valuation. Where employers outsource the payroll function, early engagement with the employer on the potential risks will help them manage their supplier.... Scheme managers should develop an understanding of the risk and benefits of a range of security types, such as charges, bonds and guarantees. Scheme managers should consider whether accepting a range of security types will offer more effective protection to the fund, rather than focussing on a single form of security.....Where security is in place, Scheme Managers should have a policy on when the security should be triggered."*

## Cyber Security:

*Findings: "Most scheme managers are heavily reliant on the security systems put in place by the Local Authority, with some not engaging with how the procedures in place affect the fund. Scheme managers of well run funds have a good*

*understanding of the IT systems in place, even where these are implemented by the Local Authority. Some scheme managers have not given consideration to the risks posed by cyber crime. For these funds, cyber security did not appear on the risk register.....”*

*Recommendations: “Scheme managers and pension boards should understand the risk posed to data and assets held by the fund so steps can be taken to mitigate the risks. This should be reflected in the risk register. Regular, independent, penetration testing should be carried out.....Where cyber security is maintained by the Local Authority.... the scheme manager should understand the procedure and ensure the fund’s requirements are met....”*

### Internal Fraud and False Claims

*Findings: “Scheme managers generally appear to have an awareness of the risks of fraud against their fund, both from an internal and external source.... Scheme managers of well run funds typically take steps to regularly screen member existence.... Most scheme managers have introduced multiple levels of sign offs, with more than one person being required to agree to a payment being made. The scheme managers were also aware of frauds involving other funds....”*

*Recommendations: “Scheme managers should regularly review their procedures to protect the fund’s assets from potential fraud. A clearly auditable process should be in place for the authorising of payments. Ideally, this would require more than one person to provide authority to make the payment. A scheme manager should have a policy in place to differentiate between a potential fraud and a potential honest mistake by a saver.....”*

### Conclusion

The Conclusion section of TPR report includes the following observations:

*“Not all funds are the same and there is a variety of equally valid approaches to mitigating risk used across funds in the LGPS”*

*“It is important that scheme managers recognise, and maintain, a separation between the fund and Local Authority to avoid an over-reliance on the Local Authority’s policies and procedures.....”* It is particularly noteworthy that this statement in the Conclusion accords with the proposals in the “Good governance in the LGPS Phase II report” concerning the need to ensure that the governance and operation of LGPS Funds takes into account careful consideration of the particular and different nature of the LGPS from other Council functions and that policies and procedures applied to the LGPS Fund should not simply be those applied to the Council in general.

*“Good quality data and record-keeping standards underpin all aspects of successfully running a fund.....”*

*“Scheme managers that have developed and implemented a robust pension administration strategy have found them useful....”*

*“A common risk is the unexpected departure of key members of the scheme manager’s staff. Succession planning and clearly recorded processes help mitigate this risk.”*

*“Measuring governance and administration is challenging and requires more than just an analysis of raw figures....”*

*“Risks to funds are constantly changing and evolving.... Scheme managers should..... adapt their approaches accordingly.....”*

#### **4. The Scheme Advisory Board (SAB) and Responsible Investment**

##### **Introduction**

At the meeting of the Scheme Advisory Board (SAB) held on 6 November 2019 approval was given for the first part of guidance on *“Responsible Investment in the Local Government Pension Scheme”* to be published for consultation with selected consultees (this is legitimate as this is only a SAB not a Government consultation). The consultees include LGPS Officers, Pension Committee Members and Pension Board Members.

This is the first of two parts of Guidance on Responsible Investment that SAB intends to publish. The Consultation period on this draft Part 1 Guidance runs until 11 January 2020. The draft Part I Guidance is sub titled *“A Guide to the duties of Investment Decision Makers in LGPS Administering Authorities.”* The aim of this first part of the Responsible Investment Guidance is to assist decision makers to identify the parameters of operation within Scheme Regulations, Statutory Guidance, fiduciary duty and the general public law and the scope for integrating Environmental, Social and Governance (ESG) policies as part of LGPS Fund’s Investment Strategy Statements.

SAB also agreed that work should commence on drafting Part 2 of the Guidance. This will aim to provide investment decision makers with a toolkit they can use to further integrate ESG policies as part of their Investment Strategy. The Board Secretariat hopes to have a working draft of the Part 2 Guidance prepared in time for it to be considered by the SAB Board when it next meets on 3 February 2020. Given the timescales indicated it appears that SAB intend to seek to issue the final Part 1 and Part 2 Responsible Investment Guidance as soon as is practical.



## Summary of the draft Part 1 SAB Guidance on Responsible Investment

The draft Part 1 SAB Guidance on Responsible Investment seeks to assist and help investment decision makers to identify the parameters of operation within Scheme Regulations, Statutory Guidance, fiduciary duty and the general public law and the scope for integrating ESG policies as part of LGPS Fund's Investment Strategy Statements.

Paragraph 3 of the draft Guidance states that *“This guidance is intended to be permissive in that it does not seek to provide operational direction but rather seeks to clarify the parameters within which decisions can be made and policies formulated with regard to the integration of ESG considerations into the overall investment strategy of the authority.”* Therefore, there is no intention by SAB to prescribe the extent to which ESG policies are adopted by each LGPS Fund as this must clearly remain a matter for local consideration and agreement in accordance with the LGPS Regulations and MHCLG Statutory Guidance. However, the fact that SAB has issued this (draft) Guidance can clearly be viewed as an encouragement towards consideration of ESG notwithstanding that it is intended to be merely *“permissive.”*

Paragraph 9 provides a definition of Responsible Investment as follows – *“According to the PRI (Principles for Responsible Investment) established by the United Nations in 2006, responsible investment is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long term returns.”*

The draft Guidance clearly sets out that ESG factors go far beyond Climate Change as shown in Paragraph 10 and Appendix 1 to the document. These lists/examples although not a comprehensive list of possible ESG factors do very clearly indicate and illustrate that Climate Change alone is not what RI/ESG is all about. This may potentially be particularly helpful to those LGPS Funds who are “not advanced” in their RI/ESG journey and/or may have been subjected to very heavy lobbying by Climate Change activists. Hopefully the (finalised) Guidance may encourage further/deeper consideration of Governance and in particular Social factors by LGPS Funds. The issue of social considerations such as employment standards, employee representation, Health and Safety, and supply chain matters are all areas where LGPS Funds as major owners of both listed and unlisted assets could have a significant and potentially positive influence to better manage risks and generate sustainable long term returns.

The draft Guidance draws on relevant guidance and regulations (for example in Paragraphs 12,13,14,15) relating to private sector pension schemes where this may be relevant/helpful to the LGPS.

The draft Guidance contains clear guidance on **“Non-Financial Factors”** in Paragraphs 16,17 and 18. If these are retained in the final guidance, they may be significant particularly if Paragraph 17 with % figure remains. Paragraph 17 of the draft Part 1 Guidance states *“Assessing whether a non-financial decision would have a significant financial detriment to the fund will always be a question of fact and degree. Divesting from a sector which makes up 15% of a fund is likely to represent financial detriment whereas a portfolio of 3% may not.”*

Paragraphs 20 to 30 remind LGPS Funds of the requirements and content of the LGPS (Management and Investment of Funds) Regulations 2016 and the Statutory Guidance of July 2017 on Preparing and Maintaining an Investment Strategy Statement as they relate to RI/ESG considerations.

Paragraph 34 reminds investment decision makers in the LGPS that their decision making must not only take proper account of the LGPS Regulations and Statutory Guidance. This paragraph states *“... As well as acting within statutory duties.... decision makers must also act in accordance with a range of non-statutory duties deriving from public law.”*

Paragraphs 35 to 42 cover wider considerations, beyond the LGPS Regulations and Statutory Guidance that investment decision makers in the LGPS should take into account. Paragraphs 35 to 42 make it clear that these considerations also go beyond merely *“the best interests of scheme beneficiaries”* stating *“Unlike private sector trustees who have a clear fiduciary duty to act in the best interests of scheme beneficiaries the position of LGPS investment decision makers is not so easily defined.”*

Paragraphs 36, 37 and 38 refer to the fiduciary duty owed to the local taxpayer and references some notable relevant legal cases – Roberts v Hopwood (1925), Bromley v GLC (1981) and Attorney General v De Winton (1906). Paragraphs 39 to 41 refers to a legal Opinion on the duties of LGPS Administering Authorities provided for SAB by Nigel Giffin QC on 25 March 2014. In this Opinion Nigel Giffin QC stated, amongst a range of observations, that not only did those making investment decisions owe fiduciary duties to scheme members but also to *“scheme employers.”* Therefore, in making investment decisions including those relating to RI/ESG matters LGPS decision makers need to take account of a range of issues/interests. Paragraph 42 is clear that there *“appears”* to be a clear difference between the duty of private sector pension trustees to always act in the best interests of scheme members and the duties upon LGPS investment decision makers. This paragraph includes a quote made (in the context of the duty owed by Elected Members to local taxpayers) in the case of Roberts v Hopwood (1925) by Lord Atkinson who referred to a duty to *“conduct...administration in a fairly businesslike manner with reasonable care, skill and caution, and a due and alert regard to the interests of those contributors who are not members of the body”*

Paragraphs 45 to 48 covers regulation relating to RI/ESG which has been introduced for private sector schemes but which does not apply to the LGPS. Paragraph 45 refers to these as *“possible developments in the LGPS...but at the time [time] of publication none...applies to the LGPS.*

#### Independent Advisor’s Summary

The issuing of the draft Part 1 Responsible Investment Guidance by SAB will further raise the profile of RI/ESG in the LGPS. It will also likely encourage a broadening of RI/ESG consideration in the LGPS.

The draft Part 1 Guidance is however likely the less important element, in terms of RI/ESG development in the LGPS, as compared with the forthcoming draft Part 2 Guidance. This will aim to provide investment decision makers with a toolkit they can use to further integrate RI/ESG policies as part of their Investment Strategy Statement and approach and which the SAB hopes to consider on 3 February 2020. Assuming this timescale is met draft Part 2 Guidance on Responsible Investment would likely be issued in February.

RI/ESG has become a major issue in the LGPS but in some ways has been “skewed” towards environmental issues, and climate change in particular. The SAB Guidance will likely further increase the focus on RI/ESG in the LGPS but, hopefully, in a manner which broadens LGPS Funds’ (as a whole) appreciation and consideration of Governance and especially Social as well as Environmental issues.

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#### References:

1.The report **“Good governance in the LGPS”**, July 2019 can be accessed at <http://www.lgpsboard.org/images/PDF/GGreport.pdf>

2. The report **“Good governance in the LGPS, Phase II report from Working Groups to SAB”**, November 2019 can be accessed at [https://www.lgpsboard.org/images/PDF/HymansRobertson\\_GoodgovernanceinthelGPS\\_Phase-II\\_November2019.pdf](https://www.lgpsboard.org/images/PDF/HymansRobertson_GoodgovernanceinthelGPS_Phase-II_November2019.pdf)

3. The report **“Governance and administration risks in public service pension schemes: an engagement report”** (The Pensions Regulator, September 2019) can be accessed at <https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/governance-and-administration-risks-in-public-service-pension-schemes-an-engagement-report>
4. The document issued by the Scheme Advisory Board **“Responsible Investment” in the LGPS Part I, draft** November 2019 can be accessed at <https://www.lgpsboard.org/images/Consultations/RIGuidance/DRAFT Part 1 Responsible Investment Guidance Final pdf version.pdf>
5. The Opinion **“Duties of Administering Authorities under the Local Government Pension Scheme”** of Nigel Giffin QC of 24 March 2014 <https://www.lgpsboard.org/images/PDF/Publications/QCOpinionApril2014.pdf>

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