

**Tower Hamlets Council LGP Scheme**

# **PENSIONS BOARD**

## **SUPPLEMENTARY AGENDA**

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**Monday, 7 March 2016 at 10.00 a.m.**

**Room MP702, Town Hall, Mulberry Place, 5 Clove Crescent, London  
E14 2BG**

**This meeting is open to the public to attend.**

**Members:**

Chair: John Jones

Vice-Chair:

Stephen Stratton, (Active Fund Members' Representative)

John Gray, (Admitted Bodies Representative for Active Fund Members)

David Stephen Thompson, (Representing Retired/Deferred Pension Fund Members)

Councillor Dave Chesterton, (Representing Pension Fund Employers)

Andrew Crompton, (Representing Admitted Bodies Employers)

Minesh Jani, (Representing Pension Fund Employers)

**Deputies**

Contact for further enquiries:

Antonella Burgio, Democratic Services.

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Committee  
website.



## **7. PENSIONS COMMITTEE AGENDA FOR THE FORTHCOMING MEETING**

Agenda attached

- 7 .1 Minutes of Pension Committee 25 November 2015 (Pages 3 - 10)**
- 7 .2 Petitions**
- 7 .3 Presentation from Fund Manager GMO**
- 7 .4 PC Item 5.1 Quarterly Report - Key Pension Administration Performance Indicators: October 2015 to December 2015 (Pages 11 - 14)**
- 7 .5 PC Item 5 .2 The Pensions Regulator Code of Practice for Public Sector Pensions Compliance Checklist For Tower Hamlets Pension Fund (Pages 15 - 136)**
- 7 .6 PC Item 5 .3 Training and Development Policy and CIPFA Guidance For Members (Pages 137 - 198)**
- 7 .7 PC Item 5 .4 Pensions Committee Work Plan for 2016/17 (Pages 199 - 208)**
- 7 .8 PC Item 5 .5 The Council Responses to the Government Investment Reform Criteria & Guidance and the Consultation on the Reformation of Investment Regulations (Pages 209 - 376)**
- 7 .9 PC Item 5 .6 Market Update**  
Verbal item
- 7 .10 PC Item 5 .7 Pension Fund Managers Investment Performance Review for Quarter End 31 December 2015 (Pages 377 - 418)**
- 7 .11 PC Item 5.8 Collaboration Work Update -National LGPS Procurement Framework and London Collective Investment Vehicle (CIV) (Pages 419 - 430)**
- 7 .12 PC Item 7. EXCLUSION OF THE PRESS AND PUBLIC**

In view of the contents of the remaining items on the agenda the Committee is recommended to adopt the following motion:

“That, under the provisions of Section 100A of the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985, the press and public be excluded from the remainder of the meeting for the consideration of the Section Two business on the grounds that it contains information defined as Exempt in Part 1 of Schedule 12A to the Local Government Act, 1972.”

### **EXEMPT SECTION (Pink Papers)**

The exempt committee papers in the agenda will contain information, which is commercially, legally or personally sensitive and should not be divulged to third parties. If you do not wish to retain these papers after the meeting, please hand them to the Committee Officer present.

#### **7 .13 PC Item 7 .1 Restricted Pensions Committee Minutes 25 November 2015**

These minutes will be circulated under separate cover.

#### **7 .14 PC Item 7 .2 Update - Fixed Income Investment**

A verbal report.

The next meeting will be held at Friday, 1 April 2016 and Room MP702, Town Hall, Mulberry Place, 5 Clove Crescent, London E14 2BG

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**Wednesday, 9 March 2016 at 7.00 p.m.**

**2. MINUTES OF THE PREVIOUS MEETING(S)**

To confirm as a correct record the minutes of the meeting of the Committee held on 25 November 2015.

**3. PETITIONS**

To receive any petitions relating to matters for which the Committee is responsible.

**4. PRESENTATION FROM FUND MANAGER - GMO**

To receive a presentation from GMO.

**5. REPORTS FOR CONSIDERATION**

**5.1 Quarterly Report - Key Pension Administration Performance Indicators: October 2015 to December 2015**

**5.2 The Pensions Regulator Code of Practice for Public Sector Pensions Compliance Checklist For Tower Hamlets Pension Fund**

**5.3 Training and Development Policy and CIPFA Guidance For Members**

**5.4 Pensions Committee Work Plan for 2016/17**

**5.5 The Council Responses to the Government Investment Reform Criteria & Guidance and the Consultation on the Reformation of Investment Regulations**

**5.6 Market Update**

To receive a verbal update on recent market activity.

**5.7 Pension Fund Managers Investment Performance Review for Quarter End 31 December 2015**

**5.8 Collaboration Work Update -National LGPS Procurement Framework and London Collective Investment Vehicle (CIV)**

**6. ANY OTHER UNRESTRICTED BUSINESS CONSIDERED TO BE URGENT**

**7. EXCLUSION OF THE PRESS AND PUBLIC**

In view of the contents of the remaining items on the agenda the Committee is recommended to adopt the following motion:

“That, under the provisions of Section 100A of the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985, the press and public be excluded from the remainder of the meeting for the consideration of the Section Two business on the grounds that it contains information defined as Exempt in Part 1 of Schedule 12A to the Local Government Act, 1972.”

**EXEMPT SECTION (Pink Papers)**

The exempt committee papers in the agenda will contain information, which is commercially, legally or personally sensitive and should not be divulged to third parties. If you do not wish to retain these papers after the meeting, please hand them to the Committee Officer present.

**These reports will be circulated in a supplemental agenda.**

**7.1 Restricted Pensions Committee Minutes 25 November 2015**

To consider and approve the restricted minutes of the meeting held on 25 November 2015.

**7.2 Update - Fixed Income Investment**

To receive a verbal update on fixed income investment.

**LONDON BOROUGH OF TOWER HAMLETS**

**MINUTES OF THE PENSIONS COMMITTEE**

**HELD AT 7.05 P.M. ON WEDNESDAY, 25 NOVEMBER 2015**

**ROOM MP701, 7TH FLOOR, TOWN HALL, MULBERRY PLACE, 5 CLOVE  
CRESCENT, LONDON E14 2BG**

**Members Present:**

Councillor Andrew Cregan (Chair)  
Councillor Clare Harrisson (Vice-Chair)  
Councillor Abdul Mukit MBE  
Councillor Candida Ronald

**Admitted Bodies, Non-Voting Members Present:**

Kehinde Akintunde – Unions Representative

**Apologies:**

Tony Childs  
Councillor Suluk Ahmed  
Councillor Harun Miah  
Councillor Mohammed Mufti Miah

**Others Present:**

Raymond Haines – Independent Investment Adviser

**Officers Present:**

Kevin Miles – (Chief Accountant, Resources)  
Bola Tobun – (Investments and Treasury Manager,  
Resources)  
Ngozi Adedeji – (Team Leader Housing Services,  
Legal Services, Law Probity &  
Governance)  
Anant Dodia – (Pensions Manager)  
Antonella Burgio – (Democratic Services)

The Chair welcomed Tony Childs and Kehinde Akintunde, newly appointed co-optees to the Pensions Committee representing admitted bodies and the Council's recognised unions respectively.

**1. DECLARATIONS OF DISCLOSABLE PECUNIARY INTEREST**

No declarations of disclosable pecuniary interests were made.

## **2. MINUTES OF THE PREVIOUS MEETING(S)**

The Pensions Committee minutes of 17 September were approved as a correct record of proceedings.

### **Matters Arising**

An update on memberships of the Council's LGPS bodies was given informing the Committee of the that the following appointments had been made:

- Mr John Gray had been appointed to the Pensions Board as Admitted Bodies Representative for Active Fund Members.
- Mr Steve Stratton had been appointed to the Pension Board as Representative for Council employees who were Active Fund Members.
- A Chair of Pension Board had yet to be appointed, however the post had been advertised and applications would close on 27 November 2015. Interviews would take place on 7 December 2015.
- Tony Childs had been appointed as co-optee to the Pension Committee representing Admitted Bodies.
- Kehinde Akintunde, had been appointed as co-optee to the Pensions Committee representing the Council's recognised Unions.

## **3. PETITIONS**

No petitions were received relating to matters which the Committee is responsible.

## **4. TRAINING - OVERVIEW OF THE PENSIONS REGULATOR CODE OF PRACTICE FOR PUBLIC SECTOR PENSIONS**

Mr Haines, Investment Adviser to the Committee delivered a training session concerned with the Pensions Regulator Code of Practice for Public Sector Pensions. The matters covered were:

- the role of the pensions regulator under the new LGPS framework
- knowledge and understanding required by pensions committees
- the requirements placed on pensions boards and pensions committees,
- conflicts of interest and
- reporting breaches.

Concerning whether the requirement to disclose personal and prejudicial interests and potential conflicts of interests was applicable to matters relating to the Pension Fund, the Board was informed that both pensions committee and pensions board members were required to comply with the Nolan Principles in public life. It was suggested that an item entitled "Potential Conflicts of Interest" should be added to the agenda of the first meeting of each municipal year.



**Action by:** - Democratic Services

Board Members were recommended to familiarise themselves with the Pensions Regulator Trustees Toolkit.

## **5. REPORTS FOR CONSIDERATION**

### **5.1 The Pensions Regulator Code of Practice for Public Sector Pensions**

Ms Tobun, Investment and Treasury Manager presented the report informing Members that the Regulator Code of Practice incorporated:

- scope of the code,
- governance of the scheme
- managing risks,
- aspects of administration and
- resolving issues.

The Code was aimed at scheme managers and members of pension boards. It placed certain duties on each of these which were described at paragraph 12 of the code of practice.

The Committee enquired whether the management of Tower Hamlets Pension Fund complied with the Regulator's requirements. A checklist was being prepared to verify the elements that would be required and an update report would be brought to the next meeting.

#### **RESOLVED**

That the report be noted.

### **5.2 Knowledge and Skills Audit**

Ms Tobun, Investment and Treasury Manager presented the report and tabled a questionnaire which she asked Members to complete. The purpose of the audit was to identify skills and any gaps in knowledge so that training could be tailored appropriately. She requested that completed forms should be returned to her in the addressed envelopes by the New Year.

#### **RESOLVED**

1. That the report be noted
2. That completed audit forms be returned to the Investment and Treasury Manager by the New Year.

### **5.3 Quarterly Report - Key Pension Administration Performance Indicators: July 2015 to September 2015**

Mr Dodia, Pensions Manager, presented the report which informed Members of the performance of the pensions administration service relating to key performance indicators in the period July to September 2015. Members noted the data reported and did not wish to make any comments.

## **RESOLVED**

That the report be noted

### **5.4 LGPS - Current Developments and Update (Pooling, MiFID II, Fossil Fuel and Scheme Advisory Board Work)**

Ms Tobun, Investment and Treasury Manager presented the report which informed Members of developments relating to the following matters:

#### *Pooling of investments*

The Committee noted:

- The Treasury viewed the development of London Collective Investment Vehicle (CIV) positively
- While the CIV enabled the Fund have a wider portfolio of properties and investments it was important to note that its purpose remained to ensure that the interests and needs of the Fund were met.
- Safeguards against undesired exposure to volatile projects could be exercised by timing the decision to invest in such portfolios so that the risks and returns would be commensurate with the volatility at the time of investment. To control its exposure to risk, Pensions Committee would be able to determine the point it wished to invest supported by the CIV.
- The Government was consulting on pooled funds and a response to this consultation would be provided by London CIV on behalf of London Councils by February 2016.

#### *Markets in financial instruments directive II (EU) (MIFID),*

The Committee noted:

- Under this EU regulation, financial services firms would be required to treat local government pension funds as 'retail clients' and would therefore be able to have access to a reduced spectrum of investments. It might be possible for pension funds to opt up to professional status however it was incumbent on local government pension schemes to prove that they could meet the criteria for acceptance under professional status (these had yet to be determined).
- The London CIV response to the government consultation would also address concerns around MIFID II.

#### *Fossil fuel divestments,*

The Committee noted:

- The LAPFF policy was not to divest from this type of investment but do to promote renewables because of its fiduciary duty to its members.
- Tower Hamlets Pension Fund was a member of LAPFF.

*Scheme Advisory Board (SAB) work on separation of pension funds*

The Committee noted:

- The National LGPS Scheme Advisory Board was established formally on 1 April 2015.
- It is tasked to encourage best practice, increased transparency and coordinate technical and standards issues.
- It will affect local government pension schemes by policing all administering authorities with pension funds.
- SAB is looking to restructure the 'administering authority' role as most of these do not undertake their own investing and some funds are not local government pension schemes
- SAB is looking to set up specific regulating structures for LGPSs and KPMG was doing analysis in this area

**RESOLVED**

That the updates be noted

**5.5 Collaboration Work Update - (London CIV and National LGPS Framework)**

Ms Tobun, Investment and Treasury Manager presented the report which provided Committee with an update on the progress of the London CIV for local government pension funds in London in collaboration with London Councils.

The committee noted:

- London CIV had been approved to operate as a Fund and an authority by FCA
- The CIV currently had eight investment managers, two of these were also held by Tower Hamlets Council.
- Three of the Tower Hamlets investment mandates would be eligible to go forward into the London CIV.
- London CIV expected assets of £6 billion to transferred to them by end of phase 1.
- London CIV was looking into ethical and social engagement monitoring. The Council's Fund was looking for some engagement with London CIV in this regard.

**RESOLVED**

That the update be noted

**5.6 2014/15 Pension Fund Annual Report and Audit Report (ISA 260 Report)**

Mr Miles, Chief Accountant, presented the report concerned with:

- the Pension Fund annual report and statement of accounts 2014 - 15 and
- the Pension Fund ISA260 report 2014 - 15 prepared by the Council's external auditors KPMG.

He advised that:

- the statement of accounts and annual report had been appropriately prepared and
- were being presented for approval subject to satisfactory consideration by the Committee. Members were asked to note the unqualified auditors opinion provided in the ISA260 report.

The Chair congratulated Mr Miles and Officers on their work and asked that deputy members of the Pension Committee in that period should also be listed in the report. Subject to this amendment, the Committee was pleased to endorse the recommendations at paragraph 2.

## **RESOLVED**

That subject to the above amendment,

1. the Pension Fund statement of accounts be approved
2. The Pension Fund annual report be approved and signed
3. The ISA260 report and external auditor's unqualified opinion be noted

## **5.7 Market and Economic Outlook**

Mr Haines, Investment Adviser to the Pensions Committee presented the verbal report giving a summary of market conditions in the current period.

The Committee noted:

- markets had almost recovered all of the outputs lost during the summer.
- markets were presently flat

Recent notable events were:

- Falling commodity prices
- A strengthening US economic recovery. This would likely lead to interest rate rises and would have implications on identified risks on the Fund.
- The Chancellor's Autumn statement had included generous provisions arising from Government expectations of the sources of tax revenues over the next five years.
- Markets presently did not offer opportunities for great gains

Mr Haines recommended the Committee adopt a 'steady as you go' approach to its investments.

**RESOLVED**

that the verbal update be noted.

**5.8 Pension Fund Investment Performance Review for Quarter End 30 September 2015**

Ms Tobun, Investment and Treasury Manager presented the report which informed Members of the performance of the Fund and its investments for the quarter 30 June to 30 September 2015.

The Committee noted the following:

- The Fund's overall value had reduced by £44 m in the period and currently stood at £1.6 million.
- The Fund in total underperformed benchmark by 1% returning a performance of -0.4% in the period
- The Fund was performing in line with benchmark at the four, at five-year periods and outperforming benchmark at the three year mark.
- Three of the Fund's eight mandates had performed at benchmark in the period
- Those that had performed below benchmark were Ruffer, Baillie Gifford Diversified Growth Fund, Schroeder and Invest Tech.
- Diversified growth funds had not performed well in the quarter
- The Baillie Gifford mandate would be transferred to the London CIV
- Historically GMO performance lagged the market but once it rallied, value performance showed to be very strong.
- Overall the Fund continues to meet its strategic performance aims.

**RESOLVED**

That the report be noted

**6. ANY OTHER BUSINESS CONSIDERED TO BE URGENT**

Nil items.

**7. EXCLUSION OF THE PRESS AND PUBLIC**

The Chair **moved** and

**It was resolved** that press and public be excluded from the remainder of the meeting in that under the provisions of section 100 of the Local Government Act 1972 as amended by the Local Government (Access to Information) Act 1985 the press and public should be excluded the remainder of the meeting for the consideration of Section Two business on the grounds that it contains information defined as exempt in Part One, Paragraph 3, of Schedule 12 A to the Local Government Act 1972, which relates to information relating to the financial or business affairs of any particular person including the authority holding the information.


**7.1 Update on Fixed Income Investment - Exempt Report**

This report was considered in closed session since the matters discussed were considered commercially and financially restricted.

The meeting ended at 8.50 p.m.

Chair, Councillor Andrew Cregan  
Pensions Committee

# Agenda Item 7.4

Non-Executive Report of the:  <b>Pensions Committee</b>  9 March 2016	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Zena Cooke - Corporate Director of Resources	<b>Classification:</b> Unrestricted
<b>Quarterly Report - Key Pension Administration Performance Indicators: October 2015 to December 2015</b>	

<b>Originating Officer(s)</b>	Anant Dodia – Pensions Manager
<b>Wards affected</b>	All wards

## Summary

This report provides Members with the quarterly monitoring information on the performance of the Pensions Administration Service.

This report covers the period, October 2015 – December 2015, Quarter 3, 2015/16.

Members will continue to receive updates on Key Performance Indicators on quarterly basis.

## Recommendations:

Members are recommended to note the contents of this report.

## 1. REASONS FOR THE DECISIONS

1.1 The report is provided for information.

## 2. ALTERNATIVE OPTIONS

2.1 There are no alternative options.

## 3. DETAILS OF REPORT

3.1 A number of key performance indicators (KPIs) are reported on quarterly basis to assess performance in key areas of work. The standards and data for Quarter 3, 2015/16 is detailed in the table below.

Key Performance Indicators from 1 October to 31 December 2015						
PROCESS	TARGET DAYS	TOTAL	WITHIN TARGET	%WITHIN TARGET	Analysis Trend	AVERAGE DAYS
Transfer in Quote	10	26	22	84.62%	↓	5.77
Transfer in Actual	10	6	4	66.67%	↑	3.67
Transfer out Quote	15	46	40	86.96%	↓	5.57
Transfer out Actual	12	20	15	75.00%	↓	1.85
Refund of Contributions	10	89	77	86.52%	↓	1.92
Preserved Benefit	15	128	88	68.75%	↓	3.60
Pension Estimate	10	28	22	78.57%	↓	3.32
Retirement Options sent to member	10	32	23	71.88%	↓	2.59
Retirement Grant paid to member	10	49	35	71.43%	↓	4.43
Death benefits - Write to next of kin	5	27	27	100.00%	↑	3.33

3.2 There has been a reduction in performance against certain targets over the past 3 months. Since the introduction of the CARE scheme several of the interfaces no longer work e.g. end of year posting, calculation of pensionable pay (this has been switched off), as the CARE scheme is not a final salary scheme. The posting of CARE Scheme pay has not been developed by our payroll provider. This issue is also affecting other local authorities. We have raised this matter with Northgate (Payroll provider) and our ICT partners – Agilisys. The solution offered by Northgate is not fit for purpose. Therefore, excel sheets have been developed to assist with the recording of these tasks. This has resulted in intensive manual input as some members have calculation based on three different types of schemes (1/80<sup>th</sup>, 1/60<sup>th</sup> and CARE). The Pension Regulator details the requirements, of what needs to be held on scheme records, which also generates additional work. There are current staff shortages due to maternity and secondment (1.6 staff). We are in the process of recruiting staff, which will be in post shortly.



**4. COMMENTS OF THE CHIEF FINANCE OFFICER**

4.1 The comments of the Corporate Director of Resources have been incorporated into the report.

**5. LEGAL COMMENTS**

5.1 There are no specific legal implications in this report.

**6. ONE TOWER HAMLETS CONSIDERATIONS**

6.1 There are no specific comments arising from this report.

**7. BEST VALUE (BV) IMPLICATIONS**

7.1 The monitoring arrangement for the Pension Fund and the work of officers, advisors and consultants should ensure the Fund optimises the use of its resources in achieving the best returns for member of the Fund.

**8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

**9. RISK MANAGEMENT IMPLICATIONS**

9.1 Accounts provide an effective mechanism to safeguard the Councils assets and assess the risks associated with its activities.

**10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

10.1 There are no any Crime and disorder Reduction implications arising from this report.

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**Linked Reports, Appendices and Background Documents**

**Linked Report**

- None

**Appendices**

- None

**Local Government Act, 1972 Section 100D (As amended)**


**List of “Background Papers” used in the preparation of this report**

- None

**Officer contact details for documents:**

- Anant Dodia – Pensions Manager : Telephone: 020 7364 4248

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Non-Executive Report of the:  <b>Pensions Committee</b>  9 March 2016	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Zena Cooke, Corporate Director of Resources	<b>Classification:</b> Unrestricted
<b>The Pensions Regulator Code of Practice for Public Sector Pensions Compliance Checklist For Tower Hamlets Pension Fund</b>	

<b>Originating Officer(s)</b>	Bola Tobun, Investment and Treasury Manager
<b>Wards affected</b>	All wards

## Summary

In the past the Pensions Regulator (TPR) had very little responsibility in relation to oversight of public service pension schemes. Recently he has been provided with a range of oversight powers as well as a requirement to put in place codes of practice for public service pension schemes covering a number of areas relating to the management of schemes. The new Code of Practice for Public Service Pension Schemes comes into force from 1st April 2015 and all schemes must now consider whether they comply with the Code.

The Pensions Regulator also issued a policy to cover compliance and enforcement for public sector pension schemes which sets out their approach to compliance with the Code and how they will support, monitor and enforce compliance where appropriate.

## Recommendations:

The Pensions Committee is recommended to:

- Note Tower Hamlets Compliance Checklist and where further work is required and being undertaken.

## **1. REASONS FOR THE DECISIONS**

- 1.1 There has been much greater focus on whether the governance of LGPS pension funds is appropriate. The introduction of Local Pension Boards and focus on increased training are just two areas which we have seen. TPR's greater legal powers of oversight extend this further and the Code of Practice is a useful means to understand what good practice looks like in these areas.
- 1.2 A good standard of governance is crucial in minimising the key risks involved in managing the Pension Fund. Although there are clear benefits for many schemes of the greater oversight powers that have been given to TPR, ensuring compliance with these areas and the much greater focus on governance results in additional work for officers and advisers of the Fund. Any costs associated with delivering the requirements of this Code and the related legal changes are immaterial in the context of the Pension Fund and any such costs are recharged to the Pension Fund.

## **2. ALTERNATIVE OPTIONS**

- 2.1 There are no alternative options.

## **3. DETAILS OF REPORT**

- 3.1 The Pension Regulator (TPR) finalised its 14th Code of Practice in January 2015 following a consultation with interested parties on the original draft and the Regulator's new powers under the Public Services Pensions Act 2013 (the 2013 Act). The new Code of Practice for Public Service Pension Schemes come into force in April 2015 and is attached as Appendix 3.
- 3.2 Although following the code itself is not a regulatory requirement, should TPR identify a situation where the legal requirements are being breached, he will use the code as a core reference document when deciding appropriate action.
- 3.3 In recent years there has been much greater focus on whether the governance of LGPS pension funds is appropriate. The introduction of local Pension Boards and focus on increased training are just two areas which we have seen. TPR's greater legal powers of oversight extend this further and the Code of Practice is a useful means to understand what good practice looks like in these areas.
- 3.4 The Pensions Regulator's Policy on compliance and enforcement sets out his powers and the consequences of not meeting the requirements under the Code which could have financial consequences and could in extreme cases lead to financial penalties.
- 3.5 The matters covered by Code 14 are:
- knowledge and understanding for members of pension boards;
  - conflicts of interest;
  - publication of information about pension boards, governance and administration;
  - internal controls;
  - record-keeping;
  - late payment of employer and employee contributions;

- information about member benefits and disclosure of information to members;
  - internal dispute resolution, and
  - reporting breaches of the law.
- 3.6 In light of the legal powers that have now been placed on TPR and the increasing focus on the governance of public service pension schemes, it is appropriate to consider whether the management of the London Borough of Tower Hamlets Pension Fund meets the overriding legal requirements and the recommended ways of working outlined in TPR's Code of Practice. The Committee were provided with the details of the Code at its meeting in November 2015.
- 3.7 The compliance checklist has now been completed with reference to the London Borough of Tower Hamlets and Members are able to identify from the checklist where the Administering Authority and the Pension Fund are able to demonstrate compliance with the Code. There are areas which are currently under development or where further improvements are required.
- 3.8 The full checklist is attached as appendix 1 for review by the Committee. As can be seen in most areas, the Fund is able to demonstrate high levels of compliance with the Code and these are highlighted in green. There are a number of areas where the Fund is in the process of being able to demonstrate compliance and in particular this relates largely to the Pensions Board, these are highlighted in grey. There are a few areas which are showing as amber meaning that there remains some further work to do to reach compliance.
- 3.9 There are other areas where the Fund is failing to meet the Code and are shown as red on the checklist. For example are risk management policy, risk register, reporting breaches and conflict of interest policy.
- 3.10 The introduction of the new LGPS 2014 led to some significant issues in terms of additional complexity both for employers and for the pension administrators and this has led to additional problems. We are aware that this is not an issue specific to the London Borough of Tower Hamlets Pension Fund and that the introduction of the new Scheme has led to significant backlogs in other funds. We continue to work hard with employers to resolve issues and ensure that scheme membership data is accurate and up to date.
- 3.11 Also attached as appendix 2 to this report is TPR's compliance and enforcement policy for public sector pension schemes issued at the start of June, which takes immediate effect and applies to the LGPS and underlines the fact that TPR is now a full time scrutiniser of the LGPS Funds. In terms of ensuring compliance this regime sets out the areas covered by the Code as being areas that the Regulator wants to ensure that funds are compliant with. The Regulator is now able to investigate any issues and is likely to conduct surveys and will also pick up on other sources to review including fund data, scheme returns, media analysis and reports. The policy makes clear that the Regulator now has real powers to investigate and intervene in funds where standards are seen as not complying with the regulations.

#### **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

- 4.1 The comments of the Corporate Director of Resources have been incorporated into the report.

#### **5. LEGAL COMMENTS**

- 5.1 The Pensions Regulator Code of Practice for Public Sector Pensions came into force on the 1<sup>st</sup> April 2015. The Code introduces the framework for the governance and administration of public service pension schemes and provides an extended regulatory oversight by the regulator. Codes of practice provide practical guidance in relation to the exercise of functions under relevant pensions legislation and set out the standards of conduct and practice expected of those who exercise the functions. It is essential the the Pensions Committee undertakes regular monitoring of the management and performance of the fund and use of the compliance checklist will assist with this.

- 5.2 The regulator is required under section 90(2) of the Pensions Act 2004, to issue one or more codes of practice covering specific matters relating to public service pension scheme. The Code is not a statement of the law and there are no penalties for failure to comply with its provisions. However the Authority must ensure that it complies with the underlying legal duties in respect of those matters specified in section 90(2). It is possible to adopt an alternative approach to that set out in the Code, however any such approach must meet any underlying legal duties of the scheme manager. Failure to do so may result in a penalty being imposed and the regulator also has the power to issue an improvement notice under section 13 of the Pensions Act 2004. The notice may be drafted with reference to the code of practice

#### **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 The Pension Fund Accounts demonstrate financial stewardship of the fund's assets. A financially viable and stable pension fund is a valuable recruitment and retention incentive for the Council.

#### **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 Any costs associated with delivering the requirements of this Code and the related legal changes are immaterial in the context of the Pension Fund and any such costs are recharged to the Pension Fund.

#### **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

#### **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 A good standard of governance is crucial in minimising the key risks involved in managing the Pension Fund. Although there are clear benefits for many schemes of the greater oversight powers that have been given to TPR,

ensuring compliance with these areas and the much greater focus on governance results in additional work for officers and advisers of the Fund.

**10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

10.1 There are no any Crime and Disorder Reduction implications arising from this report.

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**Linked Reports, Appendices and Background Documents**

**Linked Report**

- NONE

**Appendices**

- Appendix 1 – LBTH Compliance Checklist as at 31<sup>st</sup> December 2015
- Appendix 2 – Compliance and enforcement policy for public service pension schemes
- Appendix 3 – Code of practice no. 14 Governance and administration of public service pension schemes

**Local Government Act, 1972 Section 100D (As amended)**

**List of “Background Papers” used in the preparation of this report**

- NONE

**Officer contact details for documents:**

Bola Tobun(Investment & Treasury Manager) x4733

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# The Pension Regulator's and Scheme Advisory Board Compliance Checklist

Date of Completion: 19/02/2016

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## Introduction

This document outlines how the London Borough of Tower Hamlets complies with the Pensions Regulator’s (TPR) Code of Practice No 14 Governance and administration of public service pension schemes (‘the TPR Code’) in relation to the management of the London Borough of Tower Hamlets Pension Fund which is part of the Local Government Pension Scheme (LGPS). It will be updated regularly by officers of the Fund and reported annually to the Pensions Committee and Pension Board (generally in February/March/April each year).

This document highlights all the key elements of the TPR Code and then evidences whether Tower Hamlets Council meets these areas of best practice. As part of this evidence it shows when the element was last checked and whether, at that point, it was considered fully, partially or not compliant. Where they are partially or not compliant, it also highlights whether Tower Hamlets Council have identified actions to be carried out to improve their current practices. Where an element is not yet active, the commentary will generally still highlight where advanced progress is being made.

Those reading this document should be mindful that the TPR Code applies equally to all public service pension schemes and therefore it is generic in nature. There may be a number of elements that are more specifically stipulated within LGPS legislation and it is not the purpose of this compliance checklist to consider that level of detail.

Further, Tower Hamlets Council may also incorporate key elements of national guidance from the LGPS Scheme Advisory Board into this compliance checklist. This version contains the checklists included as part of the Shadow Scheme Advisory Boards “Guidance on the creation and operation of Local Pension Boards in England and Wales”.

## Key

**Frequency of review and last review date:** Where a process, policy or practice is officially reviewed at a set interval, the actual interval will be shown as well as the last interval date. However, in many circumstances processes and procedures are ongoing and part of the day – to - day operation of the Fund. In these circumstances, an annual check will be carried out to ensure that the ongoing process meets the TPR Code expectations and therefore the date shown will be the date that annual check was carried out and the frequency will be shown as “ongoing (annual check)”.

Completed:	Compliant:	Where responsibility relates to employers:
Fully completed	Fully compliant	Employers - Fully compliant
In progress	Partially compliant	Employers - Partially compliant
Not started	Non-compliant	Employers - Non-compliant
Not yet relevant	Not yet relevant	Not yet relevant

### Definitions:

<i>PSPA13</i>	Public Service Pensions Act 2013
<i>LGPS</i>	Local Government Pension Scheme
<i>TPR</i>	The Pensions Regulator
<i>TPR Code</i>	The Pensions Regulator’s Code of Practice No 14 Governance and administration of public service pension schemes
<i>Scheme Manager</i>	For the London Borough of Tower Hamlets Pension Fund, this is Tower Hamlets Council (sometimes referred to as LBTH).
<i>Administering Authority / LBTHPF</i>	The LGPS specific term for Scheme Manager. For the London Borough of Tower Hamlets Pension Fund, this is Tower Hamlets Council (sometimes referred to as London Borough of Tower Hamlets or LBTH).
<i>IDRP</i>	Internal Dispute Resolution Procedure
<i>SAB</i>	The national LGPS Scheme Advisory Board
<i>PC</i>	Pensions Committee
<i>LPB</i>	Local Pension Board

## Summary Dashboard

A dashboard showing the summary of the results of the latest compliance checklist is shown below:

No.	Check Completed	Compliant
<b>Reporting Duties</b>		
A1	Fully completed	Fully compliant
A2	In progress	Partially compliant
A3	Not yet relevant	Not yet relevant
A4	Fully completed	Non-compliant
<b>Knowledge and Understanding</b>		
B1	Fully completed	Fully compliant
B2	Fully completed	Fully compliant
B3	Fully completed	Fully compliant
B4	Fully completed	Fully compliant
B5	Fully completed	Fully compliant
B6	Fully completed	Partially compliant
B7	Fully completed	Non-compliant
B8	Fully completed	Fully compliant
B9	Fully completed	Non-compliant
B10	Fully completed	Partially compliant
B11	Fully completed	Fully compliant
B12	Fully completed	Non-compliant
<b>Conflicts of Interest</b>		
C1	Fully completed	Non-compliant
C2	Fully completed	Partially compliant
C3	Fully completed	Partially compliant
C4	Fully completed	Partially compliant
C5	Fully completed	Non-compliant
C6	Fully completed	Partially compliant
C7	Fully completed	Partially compliant
C8	Fully completed	Partially compliant
C9	Fully completed	Partially compliant
C10	Fully completed	Fully compliant
C11	Fully completed	Fully compliant
<b>Publishing Information</b>		
D1	Fully completed	Fully compliant
D2	Fully completed	Partially compliant
D3	Fully completed	Fully compliant
D4	Fully completed	Fully compliant

No.	Check Completed	Compliant
<b>Risk and Internal Controls</b>		
E1	Fully completed	Non-compliant
E2	Fully completed	Non-compliant
E3	Fully completed	Non-compliant
E4	Fully completed	Non-compliant
E5	Fully completed	Non-compliant
E6	Fully completed	Non-compliant
E7	Fully completed	Partially compliant
E8	Fully completed	Partially compliant
<b>Maintaining Accurate Member Data</b>		
F1	Fully completed	Partially compliant
F2	Fully completed	Partially compliant
F3	Fully completed	Partially compliant
F4	Fully completed	Fully compliant
F5	Fully completed	Fully compliant
F6	Fully completed	Fully compliant
F7	Fully completed	Partially compliant
F8	Fully completed	Fully compliant
F9	Fully completed	Fully compliant
F10	Fully completed	Fully compliant
F11	Fully completed	Partially compliant
<b>Maintaining Contributions</b>		
G1	Fully completed	Fully compliant
G2	Fully completed	Fully compliant
G3	Fully completed	Partially compliant
G4	Fully completed	Non-compliant
G5	Fully completed	Partially compliant
G6	Fully completed	Fully compliant
G7	Fully completed	Employers - Non-compliant
G8	Fully completed	Partially compliant
G9	In progress	Partially compliant
<b>Providing Information to Members and Others</b>		
H1	Fully completed	Non-compliant
H2	Fully completed	Fully compliant
H3	Fully completed	Fully compliant
H4	In progress	Partially compliant
H5	Fully completed	Fully compliant
H6	Fully completed	Fully compliant

No.	Check Completed	Compliant
<b>Internal Dispute Resolution</b>		
H7	In progress	Employers - Non-compliant
H8	Fully completed	Non-compliant
H9	In progress	Non-compliant
H10	In progress	Partially compliant
H11	Fully completed	Fully compliant
H12	In progress	Partially compliant
H13	Fully completed	Partially compliant
<b>Reporting Breaches</b>		
I1	Fully completed	Fully compliant
I2	Fully completed	Non-compliant
I3	Fully completed	Fully compliant
I4	Fully completed	Non-compliant
I5	Fully completed	Fully compliant
I6	Fully completed	Partially compliant
I7	Fully completed	Fully compliant
I8	In progress	Non-compliant
I9	Fully completed	Not yet relevant
<b>Scheme Advisory Board Requirements</b>		
J1	Fully completed	Partially compliant
J2	Fully completed	Non-compliant
J3	Fully completed	Non-compliant
<b>Scheme Advisory Board Requirements</b>		
K1	Fully completed	Fully compliant
K2	Fully completed	Partially compliant
K3	Fully completed	Fully compliant
K4	Fully completed	Fully compliant
K5	Fully completed	Fully compliant
K6	Fully completed	Non-compliant
K7	Fully completed	Partially compliant
K8	Fully completed	Partially compliant
K9	Fully completed	Partially compliant
K10	Fully completed	Partially compliant
K11	Fully completed	Fully compliant
K12	Fully completed	Non-compliant
K13	Fully completed	Non-compliant
K14	Fully completed	Fully compliant
K15	Fully completed	Fully compliant

## A - Reporting Duties

Note the requirements in this section are not included in the TPR Code but they are a fundamental to the relationship with TPR.

### Legal Requirements

All public service pension schemes have to be registered with TPR. In addition, all schemes must provide a regular scheme return to TPR, containing prescribed information. A return is required when the scheme receives a scheme return notice from the regulator. The scheme manager must also keep the regulator informed of any changes to registrable scheme details.

Note the requirements in this section are not included in the TPR Code but are a requirement for all schemes.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
A1	Is your scheme registered with the Pension Regulator?	Yes - Anant Dodia (the Pension Manager) is the contact on the registration.	n/a already registered	27/01/2016	Fully completed	Fully compliant	New registration will only be required if a new LGPS is created that is deemed to be a separate scheme	
A2	Is the information held on the Pensions Regulator's website about the scheme up-to-date?	No new employers have been admitted for a long period of time, other than Academies. Academies as well as all other scheduled and admitted bodies should be included and so there is likely to be a need to update the employer details held by the Regulator for the new Academies.	Ongoing (annual check)	27/01/2016	In progress	Partially compliant		Anant to check when employer details were last updated, and if out of date update and then update when each new employer joins
A3	Have you completed this latest Scheme Return in the required timescale?	Bespoke public sector returns have not yet commenced.	Ongoing (annual check)	27/01/2016	Not yet relevant	Not yet relevant		
A4	Have you responded to the latest TPR public service pension scheme survey/questionnaire?	Not completed last survey which was a trail version. Plan is to complete future required survey.	Ongoing (annual check)	27/01/2016	Fully completed	Non-compliant		Complete all future surveys - this audit document may assist with completion.

## B - Knowledge and Understanding

### Legal Requirements

A member of the pension board of a public service pension scheme must be conversant with:

- the rules of the scheme, and
- any document recording policy about the administration of the scheme which is for the time being adopted in relation to the scheme.

A member of a pension board must have knowledge and understanding of:

- the law relating to pensions, and
- any other matters which are prescribed in regulations.

The degree of knowledge and understanding required is that appropriate for the purposes of enabling the individual to properly exercise the functions of a member of the pension board.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
B1	Are there policies and arrangements in place to support pension board members in acquiring and retaining knowledge and understanding?	Training policy statement in place - covers both committee and board members. This is based on the committee members' policy and so may need to be updated to specifically reference the TPR requirements and any other additional requirements for the pension board, such as the recent CIPFA Pension Board knowledge and skills framework. Training policy is available on website (i.e. via meetings information) and detailed in the annual report.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		Policy statement could be updated for some specific board member training requirements, the updated CIPFA list for PB (includes additional items such as administration), a list of key documents and officer training/knowledge requirements.
B2	Has a person been designated to take responsibility for ensuring the framework is developed and implemented?	Corporate Director of Resources is responsible for the implementation of the policy a. This is detailed in the policy. On a day to day basis (e.g. the work plan) the Investment and Treasury Manager arranges and manages training for PC and LPB members.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
B3	Is the Fund providing assistance to pension board members to determine the degree of knowledge and understanding required?	Much of the focus, to date, has been on the PC, including an annual consideration of the Training Policy/CIPFA requirements and a training plan. This is being rolled out to the Pension Board gradually as part of ongoing induction. Governance training was included in the first meeting (July 2015). A knowledge and skills training needs analysis is underway - the pension board members have been given specific questions on what certain elements are, e.g. performance monitoring, investment, actuarial valuations, legislation. This analysis was provided by Hymans (based on CIPFA requirements). Not all board members have returned these, but they have been chased and it is expected this will be discussed at the March 2016 meeting, this is hoped to assist with planning of the training for next year. At the first LPB meeting the Investment & Treasury Manager also went through the annual report to show PB members all the policies that need to be aware of e.g. SIP, admin strategy, comms, and training policy and accounts. The roles and responsibilities were also explained. The training provided to members gave a list of key documents (available in public meeting pack online) which the PB members need, and they were all told documents are available either on the website or by asking the Investment & Treasury Manager - and were also given a copy of the annual report by email.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
B4	Are the roles and responsibilities of pension boards and members of pension board clearly set out in scheme documentation?	Board members Terms of Reference sets out the roles and responsibilities of the Board Members and covered as a key part of the agenda at the first LPB meeting (28/7/15). Further there was an initial training session explaining the roles of the different parties involved with the Fund.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
B5	Are pension board members aware of their legal responsibility in terms of Knowledge and Understanding?	This is detailed in Terms of Reference which were provided and discussed at the first LPB meeting (28/7/15). Also in first meeting on 28 July 2015 there was specific governance training including roles and responsibilities and the key statutory documents.  The Training Policy and requirements were further covered at the 1/10/15 LPB, including the legal requirements relating to their knowledge and skills.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
B6	Have all pension board members got access to copies of the scheme rules and relevant Fund documentation?	Annual report has been provided in the first PB meeting and by email (and each annual report will be available in future years in meetings etc.) and also online. It contains all the key policies and strategies. These key documents were highlighted as part of initial training at 28/7/15 LPB meeting.  Other scheme documentation is available online, via PC meeting packs which all LPB members have access too. LPB members have been told they can request documents from the Investment & Treasury Manager.  A few of the recommended items may not have been seen yet by the PB members e.g. the valuation report/rates and adjustments certificate, the IDRP, the Scheme Booklet, discretions, and there are some policies which are not yet drafted for the Fund i.e. Conflicts, Breaches, Risk Management.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Ensure LPB receive final key documents recommended.
B7	Is there an up-to-date list of the Fund specific documents with which pension board members need to be conversant in?	Not explicitly listed, but was implied through annual report and accounts and training. The training policy will be updated to include these items	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Training Policy to be updated with list of key documents.
B8	Are all pension board members investing sufficient time in their learning and development?	Much of the training has been provided as part of LPB meetings and attendance to date is good, albeit it is early days. A log is maintained of who has been to which meeting and training and the record will be reported in annual report and accounts as for committee.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
B9	Does the Fund offer pre-appointment training for new pension board members or mentoring by existing members?	Pre-appointment training is not offered (nor is mentoring), but once members start they are given training. All are motivated and have been keen to get hold of the required information to date.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		
B10	Is there a process in place for regularly assessing the pension board members' level of knowledge and understanding is sufficient for their role, responsibilities and duties?	See comments in B3 - the knowledge and skills analysis will be carried out annually, albeit to date not all LPB members have completed it.	Annual	02/02/2016	Fully completed	Partially compliant		
B11	Are records of learning activities being maintained?	A log is maintained of who has been to which meeting and training and the record will be reported in annual report and accounts as for committee.	Ongoing (each meeting)	02/02/2016	Fully completed	Fully compliant		
B12	Have the pension board members completed the Pension Regulator's toolkit for training on the Code of Practice number 14?	It has been mentioned to LPB members but not formally set as a requirement as yet as there has been a lot to take in initially. It is agreed this is a useful training tool so will be added to the requirements going forward, and it will be considered whether to use the modules in training sessions in meetings.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Will recommend board members carry it out - put in policy, and consider going through as group in meeting.



## C - Conflicts of interest

### Legal Requirements

The Public Service Pensions Act 2013 sets out the legal requirements for scheme managers and pension boards for conflicts of interest.

In relation to the pension board, scheme regulations must include provision requiring the scheme manager to be satisfied:

- that a person to be appointed as a member of the pension board does not have a conflict of interest and
- from time to time, that none of the members of the pension board has a conflict of interest.

Scheme regulations must require each member or proposed member of a pension board to provide the scheme manager with such information as the scheme manager reasonably requires for the purposes of meeting the requirements referred to above.

Scheme regulations must include provision requiring the pension board to include employer representatives and member representatives in equal numbers.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
C1	Does the Fund have a conflict of interest policy and procedure, which include identifying, monitoring and managing potential conflicts of interest?	There is currently no formal policy for conflicts of interest for the pension fund (board or committee) though it is mentioned in the PB and PC Terms of Reference. It has been recognised that this is best practice to have a conflicts management policy in place for the Fund and so is looking to develop this.  The LBTH Council's constitution includes the requirement to declare disclosable pecuniary interests in the Code of Conduct, and so all PB and PC members have followed this requirement. However, this does not cover all circumstances that would be covered in a Fund specific Conflicts of Interest Policy.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Putting in place a formal conflicts policy for the Fund, which includes how to identify and manage potential conflicts and once in place this should be reviewed on a regular basis (e.g. annually).
C2	Do pension board members have a clear understanding of their role, the circumstances in which they may have a conflict of interest and how to manage potential conflicts?	The pension board (and committee) have had high level training on the TPR requirements and the requirements in relation to conflicts are briefly set out in the Terms of Reference. However it is noted that this could be emphasised further through the implementation of a formal policy and register for the fund, and a dedicated training session covering conflicts of interest (this may involve the TPR toolkit module).  The declaration of pecuniary interests completed for the council may have highlighted some of the relevant considerations in this area.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Consider a dedicated training session on this topic including when any policy formally implemented and introduced.
C3	Have all Pension Board members provided appropriate information for the Administering Authority to determine whether a conflict exists (on appointment and from time to time)?	PC and LPB have made declarations in line with the Council's Code of Conduct requirements (see C1) and declarations of pecuniary interests is a formal item on each LPB (and PC) agenda. However, as noted previously, this may not cover all aspects as would be covered with a Fund specific situation.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		See other actions which cover formal requirements to be documented for the Fund
C4	Does the appointment process for pension board members require disclosure of interests and responsibilities which could become conflicts of interest?	No declarations to date in the appointment process under any pension Fund requirement (this is looked at once appointed by way of the Council Code of Conduct declaration). However, as per previous points, this may not pick up all Fund specific situations.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Consider including requirement for future members to make declarations at application/pre-appointment stage to minimise risk of appointing potentially conflicted members.
C5	Is the conflicts policy regularly reviewed?	No conflicts policy currently in place but in progress - including the requirement for regular review of the policy (i.e. annually, no later than every three years).	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Include need for regular review of the policy within policy wording
C6	Does the Fund have a conflicts register and it is circulated for ongoing review and published?	There is only the Council's pecuniary interest register. There is no current conflicts identification and management process covering wider Fund potential conflicts, this is being implemented currently and this will include the maintenance of a conflicts register to be published and reviewed as a standing agenda item.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Include a Pension Fund Conflicts register (for PB and PC) in the conflict policy/process to be drafted.
C7	Is appropriate information included in the register?	The register for Council pecuniary interests excludes potential conflicts from wider roles and responsibilities in relation to the Fund. This is being developed/considered and will include the TPR recommended elements as well as any other information considered of use to the PB/PC.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Ensure the conflicts register includes all recommended items.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
C8	Is there a standing item on the agenda for declaring conflicts of interest?	There is a standing item but it is focussed on Council pecuniary interests.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		
C9	Do those involved know how to report a conflict of interest?	There has been some high level training including on the Code of Practice, and the opportunity to declare conflicts from a Council declaration requirement, as well as the opportunity to raise concerns at PB and PC meetings when considering the agenda - declarations of interest is on each agenda.  However it is recognised that there could be more explicit training and it would be ideal to have this set out in a formal policy, and to cover this more fully in a future training session. It is recognised the TPR's module on the toolkit will provide useful training for members.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Include in policy how to highlight a potential conflict.  Recommend members complete the TPR toolkit training (or carry out this module as part of next committee/board training)
C10	Is the number of employer and member representatives on the board in line with legal requirements?	The board is made up of 3 member representatives, 3 employer representatives (including 1 Admission Body) and 1 independent chair which meets scheme regulation requirements. All positions are currently filled.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
C11	Is the board made up of the appropriate mix of representatives in order to minimise potential conflicts?	It is believed that the make up includes suitable representation from membership and employers and includes an independent chair. It also includes a wide range of quite different backgrounds. There were no selection interviews, but it is considered the balance of membership is suitable and all are engaging with the training provided.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		



## D - Publishing information about schemes

### Legal Requirements

The scheme manager for a public service scheme must publish information about the pension board for the scheme(s) and keep that information up-to-date.

The information must include:

- who the members of the pension board are
- representation on the board of members of the scheme(s), and
- the matters falling within the pension board's responsibility

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
D1	Does the Administering Authority publish information about the pension board?	The Committee area of the Tower Hamlets council website provides information relating to the LPB via the committee meeting/agenda pages.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
D2	Does the Administering Authority publish other useful related information about the pension board?	<p>The details of which members represent which parties as well as the job title and employment is currently provided via meeting papers on the committee site. This could be made more explicit.</p> <p>The responsibilities/TOR of the members are currently not given on the website but are available by looking through meeting packs.</p> <p>The appointment process is not included on the website at this stage (albeit a broad overview of how the members were appointed would be sufficient at this stage).</p> <p>There currently is no Pension fund website, and LBTH are considering creating a site and are looking into the options to implement this e.g. via a link from Council site, or an independent site provided by a platform provider.</p>	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		The information provided should be updated to include details of job title, employment, representation and responsibilities (e.g. Terms of Reference) on the committee website or a future LBTH Pension Fund website
D3	Is all the information about the Pension Board kept up-to-date?	All information which is put onto the website is up - to - date so far. The Governance officer / clerk for the committee is responsible for making sure information is uploaded to the website after meetings - and this is also being carried out for the pension board.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
D4	Does the Administering Authority public information about pension board business?	All meetings and papers (PB and PC) are public (some PC items may be restricted).	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		

## E - Managing risk and internal controls

### Legal Requirements

The scheme manager must establish and operate internal controls which adequately ensure the scheme is administered and managed in accordance with the scheme rules and the requirements of the law.

Internal controls are defined in the legislation as:

- arrangements and procedures to be followed in the administration and management of the scheme
- systems and arrangements for monitoring that administration and management
- arrangements and procedures to be followed for the safe custody and security of the assets of the scheme

The legal requirements apply equally where a scheme outsources services connected with the running of the scheme.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
E1	Is there an agreed process for identifying and recording scheme risks?	<p>The Pension Manager (Anant Dodia) has fed into the identification of the administration risks with the Council's risk manager for LBTH but not formally for the pension fund (at the time there was also some discussion about how those risks could be mitigated). The Council's final risk register has not been shared with the pension team though the Committee has access - there is not much information relevant to the pension fund included - there has been insufficient time to discuss this with PC/PB members in meetings to date.</p> <p>The Pension Manager is not always given access to audit reports (but could access them if required as public documents as part of meeting papers) - currently this is not formally used for setting controls/identifying risks for the pension fund.</p> <p>To date, other than the items mentioned above there has been no formal process for identifying risks for the pension fund. It has been identified through the TPR compliance checking process that this is an area which needs development and so the implementation of a formal risk management strategy/policy and register is being considered.</p>	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant	There may be some overlap in the risks identified for the LBTH and the Fund, but the Fund should have it's own risk management procedures.	Put in place a formal risk management policy and risk register for the Fund. Could use the CIPFA guide for this.
E2	Does the Fund have an adequate process to evaluate risks and establish internal controls?	<p>Not currently in place - this has been identified as an area which needs to be addressed as soon as possible.</p> <p>It is recognised that there are good internal controls in place in many areas fund management, but there is no formal identification/documentation of these for risk management and monitoring purposes.</p>	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		As above
E3	Does the Administering Authority have a risk register to record all risks identified and action taken?	There is no Fund Risk register currently in place - this is under consideration and when implemented will include the TPR recommended items.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant	<p>TPR guidance: The risk register should contain:</p> <ul style="list-style-type: none"> <li>- details of the risks identified</li> <li>- the likelihood of the risk arising</li> <li>- the impact of the risk if it does arise</li> <li>- the actions taken to mitigate the risk</li> <li>- when mitigation action was taken</li> <li>- when the risk and mitigation should next be reviewed</li> <li>- who has responsibility for monitoring the risk, if it is not the scheme manager</li> </ul> <p>TPR also provides a sample risk register on the website.</p>	Risk register to be drafted and to include recommended items

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
E4	Does the Administering Authority review the effectiveness of the risk management and internal control systems of the Fund?	Given there is no formal risk policy or procedure it is not possible to review the risk management functions fully, and there is no formal process for the review of the effectiveness of the internal controls we have identified. However, as identified below (E) However as identified below (E7) there are substantial internal controls in place including a number of ongoing monitoring areas that are reported to PC (investment matters and administration).	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		
E5	Does the Administering Authority regularly review the risk register?	The currently is no risk register but it has been agreed that one should be put in place for the Fund.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Recommend at least annual review of the risk register by PC and possibly PB (at least shared with PB) once in place, but more often focussing on key or new risks.
E6	Is there a standing item on the Pension Board agenda to review scheme risks?	There is not currently a standing agenda item on Board or Committee meetings for risk discussions - it has been agreed this should be added once policy and risk register in place	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Include as standing agenda item for PC/PB
E7	Does the Administering Authority have adequate systems, arrangements and procedures (internal controls) in place for the administration and management of the Fund and are they documented ?	There is a large range of internal controls in place which may transpire to be adequate (examples shown below). Areas where improvements could be made are in the documentation of existing processes and documentation of risk management so that it can be more regularly reviewed. The team is also currently developing reporting against administrative KPIs/SLAs for the pension board. In particular, the administration processes should identify who is authorised to carry out the various stages (e.g. checking).  Examples of internal controls currently in place: Access to building restricted / Disaster recovery systems in place / Altair (pension admin system) is tested at a national level / Use of Altair automated workflow/task management for certain standard tasks / All calculations are checked and when payments made checked by third person / Monthly reconciliation of records - checks on data errors, missing data, number of records etc. / National Fraud Initiative checks / Annual benefit statements process and statements require members check their details / Password security on Altair so restricted access for personnel including disabling former staff / Member comms scanned on internal systems and kept next to each member records / Overseas pensioners - life certificate checks / BACS pension payments for all but 2 members / Planning and testing of annual exercise for benefit statements / Filters for spam email etc. / Data systems backed up regularly (hosted externally and retained off site) / Triennial valuation identifies data issues and "fixed" at time / Monthly reconciliation of lump sums etc. on Egress / Bank reconciliation - with the paperwork notifying of the payments etc. including things like fund managers and custodian transactions / Any movements of cash with the custodian requires two authorised signatories (out of five named individuals) / State Street (custodian) have a written agreement re how everything is communicated as well as a separate internal controls document / Only certain people have access to custodian website / Invoices can only be authorised by specified pension fund officers/purchase orders required for all invoices / Budgets in place and all invoices are checked to ensure they are correct and in line with what was agreed / Balance between Altair and Agresso systems is checked on monthly basis for non-regular payments to members such as refunds, lump sums, tv ins and out.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant	There are many controls in place and LBTH may consider this to be sufficient to feel comfortable that these address all material fund risks. However, until a formal risk register is in place, it is unclear whether the controls in place are adequate.	Add a page at beginning of admin procedure manual to set out which staff is authorised to do which tasks (i.e. checking etc.). Formal documentation of internal controls in place as part of risk management policy/register.
E8	Do these procedures apply equally to outsourced services, are internal controls reflected in contracts with third party providers and is there adequate reporting in relation to those controls?	AVCs are provided by external providers. There is a low take up of this option, and contracts with current providers have been in place for a long time so contracts have not recently been reviewed. The providers of AVCs (Aviva and Equitable Life) as well as the custodians and fund managers are not providing regular reporting/information and so this may be an area for consideration. However Equitable Life has recently provided information relating to its internal controls.  Otherwise, annual AAF reports (internal control reports) are obtained from Fund Managers and from State Street (Custodian).	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Consider development of contracts with AVC providers and consider inclusion of KPIs/SLAs and regular reporting on their audit reports and confirmation of their internal controls.

## F - Maintaining accurate member data

### Legal Requirements

Scheme managers must keep records of information relating to:

- member information
- transactions, and
- pension board meetings and decisions.

The legal requirements are set out in the Public Service Pensions (Record Keeping and Miscellaneous Amendments) Regulations 2014 ('the Record Keeping Regulations').

The Data Protection Act 1998 and the data protection principles set out additional requirements for using, holding and handling personal information. Other requirements are set out in the:

- Pensions Act 1995 and 2004
- Pensions Act 2008 and the Employers' Duties (Registration and Compliance) Regulations 2010
- Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715)
- Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1997 (SR 1997 No 94)
- Registered Pension Schemes (Provision of Information) Regulations 2006 (SI 2006/567)

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
F1	Do member records record the information required as defined in the Record Keeping Regulations and is it accurate?	LBTH use Altair as their main administration system. It records all member and beneficiary information set out in Record Keeping Regulations apart from: - requirement to record AVC information. This is an element that is effectively outsourced to the AVC provider. AVC statements are produced by the providers and LBTH issue them to the members once scanning them (so they are held on each LBTH Altair member record). Other than this, very little information is held on Altair. It will be necessary for LBTH to obtain assurance from AVC providers (Aviva and Equitable Life) regarding complying with the requirements in relation to AVCs.	Ongoing (annual check)	27/01/2016	Fully completed	Partially compliant		Emails sent to AVC providers asking if they comply - responses outstanding.
F2	Does the Fund have the appropriate processes in place so employers can provide timely and accurate information?	Procedures are not formally documented. However, at the beginning of the year all employers are provided with an updated contribution table, a guide to accompany the monthly return spreadsheet explaining in full the format and requirements and where further guidance can be found, and required timescales, and even provides format verifications to assist employers. It also explains what is required at year end.  However, data is considered to be quite accurate due to the ways of working with employers, which varies by employers e.g.: '- Monthly interface files from the LBTH payroll system in relation to all employers who are paid by LBTH, ensures all changes (joiners, leavers etc.) are identified at least monthly, Employers have been asked to fill in the standard spreadsheet but this is not always returned in the required format. - Other employers (about 22 in total) have a standard excel to keep up to date albeit some still use forms for notification of changes. Some concerns over the accuracy of pay data for some employers. - interfaces between pensioner records on payroll and Altair ensure things such as addresses are up to date. - All correspondence relating to members is scanned onto Altair and linked to the member record, but older correspondence may be stored on a different system. - Members records are updated annually for contributions and monthly for pay figure - the team are considering moving to monthly for contributions as well.  Currently the processes often result in the administration team identifying any information requirements and then proactively chasing employers for information required. However it is noted that more documented instructions could help improve the flow of timely and accurate information. There are central guides produced by LGE that could be circulated to employers.	Ongoing (annual check)	27/01/2016	Fully completed	Partially compliant		Send LGE guide around on annual basis, or create an alternative administration guide, and distribute to employers so aware of requirements.  Consider monthly update of contributions on member records.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
F3	Does the Fund keep records of and reconcile transactions as required by the Record Keeping Regulations?	The specific requirements of the record keeping regulations are adhered to except: - Employer contributions are not recorded to the member record on Altair and Pension Fund records are not maintained with this information for all employers (albeit, for LBTH paid employers, the information can be extracted from the LBTH payroll) - this is not a compliance matter relating to the record keeping legislation but more best practice to clarify delegated responsibilities.  Other points identified of note are: '- Pension increases are detailed in resource link including breakdown of elements, but there is currently no comparing to member records so there is possibly some inaccuracies in the data held on Altair. - Although information is held for all write offs, officers have identified it would be helpful to have a fund specific policy in relation to write offs.	Ongoing (annual check)	27/01/2015	Fully completed	Partially compliant		- Change processes so employer contributions are held at member level. - Consider introducing additional reconciliation between Altair and Resourcelink pensioner payroll records. - Consider a Fund specific formal policy/procedure for dealing with write offs
F4	Are records kept of pension board meetings as required by the Record Keeping Regulations?	Clerk for Committee also does this for PB meetings and all details are posted on LBTH website.	Ongoing (annual check)	27/01/2015	Fully completed	Fully compliant		
F5	Are records kept of decisions made by the pension board, outside of meetings as required by the Record Keeping Regulations?	No decisions made by LPB are outside normal meetings.	Ongoing (annual check)	27/01/2015	Fully completed	Fully compliant		
F6	Are records retained for as long as they are needed?	Records are retained indefinitely, i.e. no member records are archived or removed from the systems as there is enough storage capacity to retain them and it is considered necessary to do so. There are no remaining paper files, all historic files including microfiche have been scanned onto an electronic system. Some records are kept on historic systems. Agresso is relatively new so all historic information is retained on there and will be kept indefinitely.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
F7	Does the Administering Authority have policies and processes to monitor data on an ongoing basis?	There is no formal policy or documented procedure for the checks that are carried out, but there is confidence in the accuracy and completeness of the vast majority of data required. Checks that are carried out include: - Annual posting of contributions, where checks are made with data versus member records to pick up any anomalies and this flows through to the benefit statements process. - There are no formal "common" data (as defined by TPR) checks, but Altair won't allow a record to be set up without common data items so this is not felt to be regularly necessary. - Triennial valuation exercise - amend records on 3 yearly basis if any issues identified by actuaries doing their data cleaning. - Only 2 pensioners are still paid by cheque not BACS so reduces risk - 2 yearly National Fraud Initiative exercise is carried out to identify deceased members. - Payslips sent in March and April and then at other times if changes in amounts occur, otherwise not sent. When payslips are returned the team then investigates any possible address errors. - Life certificate exercise is carried out every year for overseas pensioners as won't be picked up via other exercises. - All benefits are checked twice when calculated and a third time before being put into payment  No checking is carried out for the setting up of new joiners but most are electronic uploads which remove manual input error risk. There are some areas where the checking procedures could be better documented and this is discussed in section E under internal controls.	Ongoing (annual check)	27/01/2016	Fully completed	Partially compliant		Consider formalising/formally documenting the checking procedures carried out.
F8	Does the Administering Authority carry out a data review at least annually?	The steps carried out in item F7 ensure that data is reviewed at least annually. Further, issues can be identified as part of the triennial valuation exercise.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
F9	Is a data improvement plan in place which is being monitored with a defined end date?	Currently there is no plan in place as there are no significant issues with data. However when issues arise, such as identification of possible deceased members following NFI checks or missing data on a monthly return, the team will allocate the work to the number of staff required to fix the issues within a suitable timescale. This approach is currently not formally documented. It is noted that should any future issues arise e.g. with meeting the deadlines for annual benefit statements, a plan would be set out for how to resolve the issue and this would be monitored and formally documented. It was further noted that this could be incorporated into their team plan.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		Ensure, if any future data issues should arise, they are formally documented in an improvement plan.
F10	Are processes and policies in place to reconcile scheme data with employer data?	Monthly return process helps identify the new joiners and leavers on a regular basis and monthly information includes postal information for members from employers - differences are investigated. This is done via Resourcelink interface for LBTH payroll paid employers. For employers not paid through LBTH payroll, spreadsheets are sent to employers with current details for them to check. These all include elements such as home addresses.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
F11	Do the Administering Authority's member data processes meet the requirements of the Data Protection Act 1998 and the data protection principles?	<p>Authority as a whole asks people to make declaration on regular basis.</p> <p>There is a LBTH DPA Officer who attended and presented/discussed on the topic recently in a team meeting.</p> <p>Egress or GSX is used for sending data to/from employers which is fully secure. Focal point is used for secure transfer of data to/from actuaries at triennial valuation time.</p> <p>It has been identified that email correspondence with members is not secure at present. However sending information to LBTH internal email addresses is OK as the systems are secure.</p> <p>Aviva might use WinZip as not one contact they deal with.</p>	Ongoing (annual check)	27/01/2016	Fully completed	Partially compliant		Check Council DPA policy about info to the public and make sure that's followed. Ensure member data is not sent to email addresses unprotected, even if member requests this. Consider putting in place additional controls which prevents unsecure emails from being sent.



## G - Maintaining contributions

### Legal requirements

Contributions must be paid as detailed below, and where not done, they should be reported to TPR in circumstances where the scheme manager has reasonable cause to believe that the failure is likely to be of material significance to TPR in the exercise of any of its functions. Reporting must be carried out as detailed below.

Contribution Type	Contributions must be paid	When a failure should be
Employer	On or before the due date as defined by the scheme regulations	To The Regulator: As soon as reasonably practicable
Employee	Paid within the prescribed period (19 <sup>th</sup> day of the month, or 22 <sup>nd</sup> day if paid electronically) or earlier date if required by the scheme regulations	Regulator: Within a reasonable period – 10 working days

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No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
G1	Does the Fund have procedures and processes in place to identify payment failures?	There is a Treasury team contribution monitoring spreadsheet which is explicit about what is required on a monthly basis in terms of checking, and there is a procedure note to explain what to do. It's objective is to focus on identifying and notifying late or incorrect contributions.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
G2	Do those processes and procedures include a contributions monitoring record to determine whether contributions are paid on time and in full?	<p>As outlined above, this is all incorporated into a Treasury team spreadsheet. It automatically flags if there is a late payment, as the sheet includes entries for dates expected and paid - the Treasury team will go in and update the sheet for dates paid when the payments arrive on the bank statement - roughly this is looked at daily around the usual payment dates. The spreadsheet would therefore indicate if an employer was a continual/regular late payment offender.</p> <p>In relation to payments being made in full, there are checks carried at both employer and employee contribution amount. These are generally carried out at total level per month, i.e. no individual spot checks unless there appears to be a bigger problem. For the Admitted bodies, the information is broken down by staff, but for LBTH there are so many members individual member checks are not carried out and only totals are therefore considered. LBTH checks are slightly different as there are so many members - these involve broad checks on the totals and only investigated if there are significant differences to expected amounts (or amounts in previous months). It is considered this is adequate as the payroll system for LBTH is considered to be more reliable. However it is noted that using this approach, there is no way to check the right contribution rate is being charged other at the year end.</p> <p>In addition, at the start of the financial year, Treasury team will look at the rates changes and check the amounts being paid agree with expectations (employers are notified of required changes in advance of the year start). In relation to LBTH paid employers, the Head of Payroll is asked to confirm the rate to pay - and the Treasury team will check its what's agreed in valuation rates and adjustments certificate.</p>	Ongoing (annual check)	02/02/2015	Fully completed	Fully compliant		Recommend more spot checks to ensure contributions actually correct member by member (for LBTH) - even without payroll this check can be carried out to ensure the ratio of employer to each employee contribution rate are correct, for example.
G3	Do those processes and procedures include monitoring payments against the contributions monitoring record on an ongoing basis?	<p>For admitted bodies, checks of the money in bank account vs amounts provided in the information for each employer and employee are carried out. The LBTH is not explicitly checked by the Treasury Team as this should be covered by separate payroll team processes, but any issues would be picked up at year end.</p> <p>Variance analysis carried out at year end to see any difference to cover any thing the monthly checks may not have picked up on.</p>	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Recommend process is updated to explicitly check amounts credited to accounts in relation to internal payroll on a monthly basis.
G4	Are these procedures regularly reviewed to ensure they are effective?	<p>Other than via internal and external audit (which should identify areas for concern), the processes are not regularly reviewed.</p> <p>There are relatively few employers in the Fund and a good relationship exists with them, so the risk of deliberate underpayment or fraudulent behaviour is considered to be minor.</p>	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
G5	Do the Administering Authority's processes include managing overdue contributions in line with TPR's suggested approach?	Not formally documented, but the Pension Manager has a procedure to follow if any contributions were materially late. This involves escalating the issue to PC and possibly the Regulator. The Treasury department passes cases to the Pension Manager to follow up when late payments are identified through their monitoring.  AVC providers contact administration team by email if they expect a contribution which is not then paid. This is then investigated - typically it will be due to a member leaving the Fund.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Formalise process to follow in situations of late or incorrect payments
G6	Does the Fund maintain a record of any investigations and communications with employers?	Where in relation to specific member information this will be retained on the member's record.  For generic contributions information the Treasury department keeps a record of communications with employers but the Pension Manager is copied in. The Pension Manager is a key contact for admitted bodies, and there's a shared area for all such emails.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
G7	Do employers provide sufficient information to monitor contributions and is this in accordance with the LGPS regulations?	Some information, such as pay information, can sometime be missing from monthly returns and no explicit returns are received for LBTH paid employers. Further, the current notifications do not include all elements required by LGPS regulations i.e. split between main scheme and 50/50 scheme members and it is not clear that the pensionable pay figure includes assumed pensionable pay.	Ongoing (annual check)	02/02/2016	Fully completed	Employers - Non-compliant		Format of return should be updated to meet LGPS regulations and ensure all received and fully completed in future.
G8	Is there a satisfactory process in place to assess the materiality of any payment failures and ensure that those which are material are reported to the Regulator within a reasonable period?	Recently payments which are delayed have been paid within 2-5 days so these are not considered material.  It is considered that the Treasury and administration teams would know how to escalate any payment breaches but a formal process is not currently documented and so this is being considered as an area for improvement.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		To be included in breaches policy which is currently being considered.
G9	If the administration of contributions outsourced to a service provider, is there a process in place to obtain regular information on the payment of contributions to the scheme?	AVCs are paid to AVC providers - confirmation is being obtained on the checks that are carried out. It has been agreed that there could be greater checking of contribution payments to ensure the amounts paid are agreed by the AVC provider, though it is expected any discrepancies would be picked up during the annual accounts audit.	Ongoing (annual check)	02/02/2016	In progress	Partially compliant		



## H - Providing information to members and others

### Legal requirements

The law requires schemes to disclose information about benefits and scheme administration to scheme members and others. This includes requirements relating to benefit statements and certain other information which must be provided under the requirements of the 2013 Act, HM Treasury directions and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ('the Disclosure Regulations 2013'). In addition to these duties, there are other legal requirements relating to the provision of information to members and others under other legislation.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
H1	Has an annual benefit statement been provided to all active members within the required timescales?	Active statements did not meet the August deadline - this was due to the difficulties with the new CARE scheme as opposed to an employer information issue. A new interface had to be created to capture the required information. Statements were sent by 30 November 2015.	Ongoing (annual check)	27/01/2016	Fully completed	Non-compliant		Ensure all processes are now in place to avoid issues for 2015/16
H2	Do these meet the legal requirements in relation to format?	The statements have been designed to follow the LGA template. The statements have been checked and include the required information in the Regulations. HMT Directions apply from next years' statements but these statements comply regardless.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
H3	Has a benefit statement been provided to all active, deferred and pension credit members who have requested one within the required timescales?	All deferred statements are automatically done (i.e. not on request) - completed at end of June/ beginning of July in 2015. This is only where the address is available -i.e. not for Gone Always where Altair has an identifier for returned mail as GA and a statement is not then automatically produced. DWP tracing is carried out roughly every year to help identify missing address for members over SPA.  In relation to pension credit members, no requests have been received for statements.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
H4	Does this meet the legal requirements in relation to format?	The statements have been checked and include the required information except in the following areas: - Deferred statements /pension credit statements missing the start date for pensionable service, the method of calculating member and survivor benefits, the survivor pension on death of the member and the date the pensionable service ended (no details on any deductions are mentioned as there are no accompanying notes). However it is possible information on individual requests does provide this information and this will need further investigated and verified.	Ongoing (annual check)	27/01/2016	In progress	Partially compliant		Consider updating statements to include the required additional information so as to ensure fully compliance.
H5	Has an annual benefit statement been provided to all members with AVCs within the required timescales?	Currently the statements are sent to LBTH to send out to members and this meets the required deadline. However there are no checks that the statements are provided for all members with AVCs - this could be an additional check to ensure data quality, using the summary information provided by the AVC providers along with the physical statements.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		Consider checking if a statement is produced by AVC providers for all members where this is expected - use summary information from AVC providers.
H6	Do these meet the legal requirements in relation to format?	The Aviva statements include all required information. The Equitable Life statements do not include any projected benefits under paragraphs 6 to 8 of Schedule 6 but this is acceptable as the statements are for members who are no longer paying contributions.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
H7	Is basic scheme information provided to all new and prospective members within the required timescales?	It is not clear whether all new employees are receiving appropriate information about the scheme and on time. There is a brief guide to the scheme but the admin team do not now issue statutory notices and therefore they are relying on it being issued prior to that point as part of the induction process. Terms and condition letters include reference to the LBTH intranet site where basic scheme information is held, but this is for LBTH employees only, and this information does not include the required level of information  It is not clear on what is provided for employees of other employers or whether it meets timescales, it is known that in general a link to the LGPS 2014 scheme page is provided.  Statutory notices (i.e. legal notices about joining the scheme) are no longer sent (ceased a few years ago) which would be one means to ensure information is being provided in the right timescales. Intrafund transfers and TV ins do result in correspondence to members.	Ongoing (annual check)	27/01/2016	In progress	Employers - Non-compliant		Review how information is circulated to new joiners, such as perhaps reinstate the use of statutory notices with a brief guide.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
H8	Does this meet the legal requirements in relation to format?	There is a brief guide to the scheme which provides the required information other than a few minor exceptions: - The statement regarding whether any charges are applied to leaving service benefits and where further information can be obtained - The comments about transfers out do not give the statement about the 1993 Act (i.e. protection for early leavers) - the conditions for re-entry after leaving could be more explicit - We aren't able to check the comments provided by the AVC provider for new AVC members as we do not have examples - e.g. on life styling and that the value may depend on the range of different possibilities. - The IDRPs leaflet is referred to but the contact details aren't provided at this early stage However, as mentioned above, it is not clear on what is provided for employees of other employers or whether it meets timescales, it is known that in general a link to the LGPS 2014 scheme page is provided (which would provide the key details about the LGPS benefits).	Ongoing (annual check)	27/01/2016	Fully completed	Non-compliant		As above (H8)
H9	Is all other information provided in accordance with the legal timescales?	It is not fully apparent whether all disclosure timescales are being met, for example: . although there is some internal reporting on KPIs, these do not necessarily measure in the same manner as legal timescales for elements such as transfers credit notifications or retirements. However, 2015 performance for Q3 is above 90% for most tasks and it is therefore expected that average times are well within the statutory requirements. - other communications include a pensioner newsletter every year with pension increase letter, deferred members received a newsletter with their statements in 2015 and active members were sent a newsletter this year with the benefit statements. Key scheme changes would generally be included in there but no strict monitoring of compliance is checked. - LBTH are waiting verification from the AVC providers regarding their compliance with these disclosure requirements	Ongoing (annual check)	02/02/2016	In progress	Non-compliant		Ongoing consideration of how better to identify if these requirements are met.
H10	Is all other information provided in the format and methods required by law?	Internal communications comply with the regulations but this cannot be confirmed until confirmation from AVC providers.	Ongoing (annual check)	02/02/2016	In progress	Partially compliant		Waiting confirmation that requirements are met from AVC providers
H11	Where any information is only provided electronically (i.e. instead of any hard copy) does it comply with the legal requirements?	No information is exclusively provided electronically (note comments above re new joiner information where there is some lack of clarity on what and how it is provided, but initial contact is via mail and hard copies can be provided of intranet material if required).  Correspondence with members via email is carried out at member request and benefit notifications and annual statements sent by post. Newsletters are sent with pension increase notifications or benefit statements.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
H12	Does the Administering Authority aim to design and deliver communications in a way that ensures scheme members are able to engage with their pension provision?	This can not be fully evidenced at this stage but there is also a plan to provide a questionnaire with questions about the communications with the next communications that go to members as there has not been a survey for some time. Communications are produced internally with the LBTH's council design team. Benefit statements are based on the LGA template, and have a paragraph which welcomes feedback in relation to the statement or any other aspect of the pension service. There are no communications related complaints, other than a few queries regarding materials for partially sighted members, where alternative materials were provided.	Ongoing (annual check)	27/01/2015	In progress	Partially compliant		Submit surveys with communications to review engagement and understanding
H13	Does the Administering Authority use a tracing service?	See F7 for checks carried out (NFI on 2 yearly basis and life certificates).  In addition pensioner cases investigated when post (payslips etc.) returned. Deferred members are generally investigated when communications are attempted close to retirement. However a tracing service is not used for younger deferred members who have unknown addresses.	Ongoing (annual check)	27/01/2016	Fully completed	Partially compliant		Consider carrying out regular tracing service checks on other deferred members.

## I - Internal Dispute Resolution

### Legal requirements

The Pensions Act 1995 requires scheme managers to set up and implement an Internal Dispute Resolution Procedure (IDRP) to help resolve disputes between the scheme manager and people with an interest in the scheme.

The act states that a person has an interest in the scheme if they:

- are a member or beneficiary
- are a prospective member
- have ceased to be a member, beneficiary or prospective member
- claim to be any of the above and the dispute relates to this claim.

The Act also states that the procedure must include:

- how an application is to be made
- what must be included in an application
- how decisions are to be reached and notified
- a specified period (which is reasonable) within which applications must be made.

The procedure may require people with an interest in the scheme to first refer matters in dispute to a 'specified person' in order for that person to consider and give their decision on those matters. This decision may then be confirmed or replaced by the decision taken by the scheme manager after reconsideration of the matters. However, legislation provides flexibility for scheme managers to decide the details of these.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
I1	Has the Administering Authority put in place an internal dispute resolution procedure?	There is a formal process in place. This is documented in IDRP leaflet. The procedure includes 2 stages for references and the IDRP leaflet and all related correspondence provides the required contact details at each stage. Stage one goes to a LBTH officer first for adjudication, who will then issue the decision letter which includes more information including information on stage 2, TPAS and the Pensions Ombudsman.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		IDRP could be updated to ensure it is up to date, and includes all required and additional helpful information. Current version is based on old DCLG sample.
I2	Does the Administering Authority's process highlight or consider whether a dispute is exempt?	This is not currently included (explicitly - some elements are implied) although those involved in the IDRP process know what circumstances are exempt and will notify the member immediately if that is the case. It is noted the IDRP leaflet is due for updating and this will be one area to be included to save members time in submitting an exempt dispute case.	Ongoing (annual check)	27/01/2016	Fully completed	Non-compliant		This detail will be included as and when the IDRP policy, procedure and leaflet /correspondence is updated.
I3	Does the information made available to applicants about the procedure clearly state the procedure and process to apply for a dispute to be resolved including: - who it applies to - who the specified person (stage 1) is - the timescales for making applications - who to contact with a dispute - the information that an applicant must include - the process by which decisions are reached?	The information to applicants includes the required items, including the target timescales (on back of IDRP leaflet), what information is required (form to complete in leaflet) and the contact details for the IDRP process.  If responses are to be delayed, the member is informed with the reason for the delay and the expected new response timescale.	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		Recommend the IDRP is updated to include as much helpful information as possible to the members and to ensure the TPR and legal recommendations/ requirements are met.
I4	Has the Administering Authority ensured that employers who make first stage decisions also have IDRP in place?	This has not been done. However, no other employers outside LBTH have had IDRP cases, but it is expected that if they were to arise, employers would pass them to LBTH for stage 1.	Ongoing (annual check)	27/01/2016	Fully completed	Non-compliant		Liaise with employers to agree a stage 1 process (which could be use of the LBTH stage 1 appointed person).

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
15	Are the timescales in the procedure adhered to including sending an acknowledgment on receipt of an application?	The expected timescales are set out in the IDRP leaflet. Although these are not formally monitored (as it is outside of pension team initially) the pensions team do try to keep an eye on timescales. They have examples of cases where there has been a delay and the member is informed with reason and expected new timescales.  An acknowledgement is sent for all new cases (example evidenced).	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
16	Does the Administering Authority notify and advertise the procedure appropriately?	Standard paragraph in all standard letters for notification of benefit letters (as evidenced on death benefit notification, retirement and correspondence relating to non-refund payment).  The guide is also on the intranet for LBTH employees.  However it is unlikely this information is being provided for new scheme members.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Ensure IDRP information is included for new joiners to the scheme
17	Are the notification requirements in relation to TPAS and the Pensions Ombudsman being adhered to?	The TPAS and Ombudsman details are provided at the required stages - evidence of standard letters have been shown at acknowledgement of dispute, and both decision stages	Ongoing (annual check)	27/01/2016	Fully completed	Fully compliant		
18	Does the Administering Authority regularly assess the effectiveness of its arrangements?	No formal reporting as such is in place (IDRP cases are quite rare and are almost exclusively Tier 3 Ill health cases), but the PB has recently asked for reports of all complaints and IDRPs cases.  The reporting of this information is now in progress - the team is currently updating their KPI performance monitoring items for the PB and will include this in the reporting. It is intended the reporting will start from new financial year i.e. April 2016.	Ongoing (annual check)	27/01/2016	In progress	Non-compliant		Recommend the PB monitors whether all disputes seem to come from one particular area, suggesting a systemic issue, and monitor timescales for dealing with IDRPs cases.
19	Does the Administering Authority regularly assess the effectiveness where employers carry out a stage one process?	There have been no employer stage 1 IDRPs to monitor	Ongoing (annual check)	27/01/2016	Fully completed	Not yet relevant		

## J - Reporting breaches of the law

### Legal Requirements

Certain people are required to report breaches of the law to the regulator where they have reasonable cause to believe that:

- a legal duty which is relevant to the administration of the scheme has not been, or is not being, complied with
- the failure to comply is likely to be of material significance to the regulator in the exercise of any of its functions.

People who are subject to the reporting requirement ('reporters') for public service pension schemes are:

- scheme managers
- members of pension boards
- any person who is otherwise involved in the administration of a public service pension scheme
- employers: in the case of a multi-employer scheme, any participating employer who becomes aware of a breach should consider their statutory duty to report, regardless of whether the breach relates to, or affects, members who are its employees or those of other employers
- professional advisers including auditors, actuaries, legal advisers and fund managers: not all public service pension schemes are subject to the same legal requirements to appoint professional advisers, but nonetheless the regulator expects that all schemes will have professional advisers, either resulting from other legal requirements or simply as a matter of practice
- any person who is otherwise involved in advising the managers of the scheme in relation to the scheme.

The report must be made in writing as soon as reasonably practicable.

No.	TPR Requirement	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Completed	Compliant	Notes	Action
J1	Is the Administering Authority satisfied that those responsible for reporting breaches under the legal requirements and TPR guidance understand the requirements?	The staff currently in place in the administration team know how to escalate any breaches and senior officers are aware of their reporting requirements. The requirements of the Code of Practice no 14 including reporting breaches was explained as training in the November Committee meeting and high level at Board meeting through looking at Committee papers review. The Treasury team also confirm they know their responsibilities in respect of their roles and breaches but this is not formally set out for the Pension Fund.  Employers and other Fund contacts have not been notified of requirements.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Consider ensuring this is explicitly covered as part of training or the introduction of a formal breaches procedure. If may be suitable to require all offices, board and committee members complete training on the requirements - for example the TPR toolkit module on breaches.
J2	Does the Administering Authority have appropriate procedures in place to meet their legal obligations for identifying and assessing breaches?	The staff currently in place in the administration team know how to escalate any breaches and senior officers are aware of their reporting requirements.  However it is recognised that this is an area that needs to be formally documented to ensure all staff, PC, PB, employers and other contacts (current and future) are able to identify breaches, how to clarify the legal points, how to decide about the material significance and where all breaches should be recorded.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Action to consider setting up a formal breaches procedure and distributing to all relevant parties including advisors, employers, officers and pension committee and board members.
J3	Are breaches being recorded in accordance with the agreed procedures?	Despite the staff having well established procedures for dealing with administrative errors, contribution breaches and delays to issue of benefit statements and other communications, these are not formally documented currently. It is considered that the risks of material breaches are low due to the levels of internal controls in place, the level of experience on the pensions team and the well established processes in place for gathering employer information. However, it is recognised that breaches are inevitable.  There is no current formal breaches procedure but it has been identified that this is an area for development. It is also agreed that reporting against this should take place as part of the reporting to the Pension Board.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		All breaches in law to be recorded and reported regularly to PC and/or PB to help identify systemic issues and ensure serious cases are reported to the Regulator.



## K - Scheme Advisory Board - Guidance on the creation and operation of Local Pension Boards in England and Wales

### Legal Requirements

Clause 7 of the Public Service Pensions Act provides that the national Scheme Advisory Board (SAB) may provide advice to scheme managers or pension boards in relation to the effective and efficient administration and management of the scheme.

It also provides that a person to whom advice is given by virtue of subsection (1) or (2) must have regard to the advice.

The Scheme Advisory Board has published guidance on the creation and operation of Local Pension Boards in England and Wales which incorporates a number of action point check lists at the end of some of the sections. The following are the items in those checklists.

No.	SAB Requirement	SAB Section	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
K1	Administering Authority to have approved the establishment (including Terms of Reference) of the Local Pension Board by 1 April 2015.	5	Established 26 November 2014	One off - no further review necessary	02/02/2016	Fully completed	Fully compliant		
K2	The Local Pension Board must be operational (i.e. had its first meeting no later than 4 months after the 1 April 2015).	5	First PB meeting was 28 July 2015. The meeting was, unfortunately, not quorate but it commenced on an informal basis with all points ratified at the next meeting in October 2015.	One off - no further review necessary	02/02/2016	Fully completed	Partially compliant		
K3	Once established a Local Pension Board should adopt a knowledge and understanding policy and framework (possibly in conjunction with the Pensions Committee if appropriate).	6	PB have approved the training framework (at the October 2015 meeting).	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
K4	A Local Pension Board should designate a person to take responsibility for ensuring that the knowledge and understanding policy and framework is developed and implemented.	6	Corporate Director of Resources is named as responsible person in policy statement	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
K5	The Administering Authority should offer access to high quality induction training and provide relevant ongoing training to the appointed members of the Local Pension Board.	6	Induction external training session by State Street was offered (most attended) and there has been training at each meeting to date. A further induction day is currently being planned (due March 2016). Further, the plan is to continue to provide training at future meetings (and use analysis of training needs to create training plans on annual basis)	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
K6	A Local Pension Board should prepare (and keep updated) a list of the core documents recording policy about the administration of the Fund and make the list and documents (as well as the rules of the LGPS) accessible to its members.	6	This is currently being considered for inclusion in the training policy - currently this is covered through the key documents included in the annual report and accounts (and accounts themselves). All of the members have been emailed a copy of the accounts as well as receiving it as part of the PC papers.	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Include list of documents in policy and ensure those are easily accessible by PB members
K7	Members of a Local Pension Board should undertake a personal training needs analysis and put in place a personalised training plan.	6	The PB members have been given an analysis to complete (see section B for more details) and this is currently underway - these should be collected by the March meeting so that training plans can be discussed. The objective is to complete these on an annual basis.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		

No.	SAB Requirement	SAB Section	London Borough of Tower Hamlets Approach / Evidence	Frequency of Review	Last Review Date	Check Completed	Compliant	Notes	Action
K8	An Administering Authority should prepare a code of conduct and a conflicts policy for its Local Pension Board for approval in accordance with the Administering Authority's constitution and at the first meeting of the Local Pension Board. The Local Pension Board should keep these under regular review.	7	The Terms of Reference have been approved which include a short section on conflicts. A formal conflicts policy for the Fund is currently being considered to cover the TPR requirements (see section C for details).	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Formal conflicts policy (see section C for more details).
K9	Training should be arranged for officers and members of a Local Pension Board on conduct and conflicts.	7	This was covered in part in the initial meeting and subsequent meetings (see details on section B and C) however further training on conflicts including implementation of the formal policy and register will take place in the coming months.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Further training for PB and PC members on Conflicts
K10	A Local Pension Board should establish and maintain a register of interests for its members.	7	This will be implemented for the PC and PB members when the formal Fund policy is drafted. Declarations have been made in line with Council requirements.	Ongoing (annual check)	02/02/2016	Fully completed	Partially compliant		Register of interests to be created for Pension Fund, rather than just Council Code.
K11	An Administering Authority should agree the ongoing reporting arrangements between the Local Pension Board and the Administering Authority.	8	These are outlined in the LPB terms of reference.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
K12	A Local Pension Board should understand the Administering Authority's requirements, controls and policies for FOIA compliance so that the Local Pension Board is aware of them and can comply with them.	8	Not explicitly covered by training yet	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Ongoing (annual check)
K13	A Local Pension Board should put in place arrangements to meet the duty of its members to report breaches of law.	8	The Fund is considering putting in place a formal breaches policy and members will receive training on the requirements (will include TPR toolkit module)	Ongoing (annual check)	02/02/2016	Fully completed	Non-compliant		Policy and training as detailed in section J
K14	A Local Pension Board should consider (with its Administering Authority) the need to publish an annual report of its activities.	8	The Chairman of the LPB is required to prepare an annual report which is published in annual report and accounts (this is in the LPB terms of reference). The first report will be due summer 2016.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		
K15	An Administering Authority should consult on, revise and publish its governance compliance statement to include details of the terms, structure and operational procedures relating to its Local Pension Board.	8	The Governance Compliance Statement (as included in the 2014/15 annual report and accounts) includes the required information.	Ongoing (annual check)	02/02/2016	Fully completed	Fully compliant		

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# **Compliance and enforcement policy for public service pension schemes**

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# 1. Introduction

The Pensions Regulator (the regulator) was established under the Pensions Act 2004 (the 2004 Act) as a non-departmental public body, sponsored by the Secretary of State for Work and Pensions, to regulate work-based pensions.

The Public Service Pensions Act 2013, together with the Public Service Pensions Act (Northern Ireland) 2014, introduces an expanded role for the regulator in overseeing the major work-based pension schemes for those working in the public services throughout the UK. Our expanded role includes regulating public service schemes in relation to the new governance and administration requirements introduced by those Acts<sup>1</sup>.

This policy sets out our approach to compliance and enforcement in relation to public service pension schemes, which are those principally covering civil servants, the judiciary, local government workers, teachers, health service workers, fire and rescue workers and members of police and armed forces. It describes our expectations for compliance with relevant legal requirements and how we will proceed in cases of non-compliance, including when we may use our enforcement powers.

This document sits under our approach to regulating work-based pensions and our public service regulatory strategy. We refer throughout to provisions of English law. References to provisions of English legislation which do not apply to Northern Ireland or Scotland should be read as references to the provisions of any corresponding Northern Ireland and Scottish legislation.

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The Public Service Pensions Act 2013 (in NI, the Public Service Pensions Act (Northern Ireland) 2014) introduces new requirements about the governance and administration of public service pension schemes and extends our regulatory responsibility, including by making amendments to the 2004 Act (in NI, the Pensions (Northern Ireland) Order 2005).

## 1.1 Approach to regulation of public service schemes

Our public service regulatory strategy sets out how we approach the regulation of public service schemes in light of our statutory objectives. We aim to ensure that all schemes meet the new governance and administration requirements as soon as possible.

Our primary focus will be on educating and enabling schemes to improve standards of governance and administration and comply with legal requirements. We will also be developing our own systems and processes to enable us to better monitor standards, assess where schemes are falling short and best direct our resources to enable them to improve standards and become compliant. We will share this information with the public service schemes to enable them to understand how they are performing alongside their peers.

Public service pension schemes have a total membership of around 13 million and there are approximately 25,000 participating employers spanning the public, private and third sectors. These reforms are significant and those involved with public service schemes face complex and challenging conditions. There are new governance and administration requirements and therefore there may be some scheme managers and pension board members who will fail to comply with the duties because they have not fully understood them. In these cases, we will focus on working with schemes in the early stages of the new regulatory regime to help them become compliant.

We expect those involved in the governance and administration of public service schemes to comply with the law and strive to deliver good outcomes for members, recognising that governance and administration standards and practices impact upon the overall service provided to members and other beneficiaries throughout their membership, including the payment of the correct benefits to the right people at the right time.

However, we are aware that there may be situations where some schemes do not fulfil their responsibilities. We regard failures to address poor standards and non-compliance with the law as unacceptable. Should a scheme manager or pension board member (or other person responsible for complying with legal requirements) fail to comply with their legal requirements under pensions legislation, we may select from one or more of our enforcement options. These range from statutory compliance notices and monetary penalties, to criminal prosecution.

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1.1 Approach to regulation of public service schemes continued...

We expect scheme managers, assisted by pension boards as appropriate, to:

- ▶ identify and understand the root causes of an issue which is resulting in poor standards of governance and administration and non-compliance with legal requirements
- ▶ develop an improvement plan which will address the root causes of that issue within a reasonable time period, and
- ▶ demonstrate implementation of their plan.

Most of our activities will be focused on educating and enabling schemes to improve standards of governance and administration – particularly in the early stages of the new regulatory regime as schemes reform and adapt to meet the new legal requirements. We will focus on:

- ▶ promoting the public service code of practice and educational tools for public service schemes
- ▶ surveying schemes to understand the extent to which they are meeting the standards and practices we expect
- ▶ engaging with schemes to understand how they are addressing poor standards and non-compliance through the development and implementation of improvement plans, focusing on key risk areas, and
- ▶ undertaking thematic reviews, focusing on key risk areas, to gather information in relation to a particular issue or set of issues and report back to our regulated community about best practice and risks.

Where scheme managers or pension board members fail to address poor standards resulting in non-compliance with the law, we may consider escalating our activities and taking enforcement action.

In considering whether to use our regulatory powers, including any enforcement action, we will take into account all of the circumstances and will act fairly and proportionately.

We will keep this policy under review and update it as required.

## 1.2 Who does this policy relate to?

This policy relates to public service pension schemes established under the Public Service Pensions Act 2013 and Public Service Pensions Act (Northern Ireland) 2014, new public body pension schemes and other statutory pension schemes which are connected to those schemes. It is not relevant to schemes in the wider public sector which are not public service pension schemes within the meaning of section 318 of the Pensions Act 2004 or Article 2 of the Pensions (Northern Ireland) Order 2005.

This policy is relevant to anyone who has legal requirements or responsibilities relating to the management or administration of a public service pension scheme, or where those responsibilities have been delegated or outsourced – for example scheme managers, pension boards and administrators. It is also relevant to anyone else who could be subject to any of our statutory powers of investigation and enforcement, such as employers and professional advisers.

## 2. Risk framework

### 2.1 Our approach to risk in relation to public service pension schemes

In this section, we explain how we will take a risk-based and proportionate approach. A key aspect underpinning our approach is how we will identify and respond to risks and prioritise our activities. In setting our strategic approach to regulating public service schemes, we are primarily guided by two of our five statutory objectives:

- ▶ To protect the benefits of members of occupational pension schemes, and
- ▶ To promote, and to improve understanding of, the good administration of work-based pension schemes.

All public service schemes must be governed and administered in accordance with the requirements of the law. Across all public service schemes, governance and administration standards and practices impact upon the overall service provided to members and other beneficiaries, including the payment of benefits.

Code of practice 14<sup>2</sup> provides practical guidance for schemes to support them in improving standards of governance and administration and complying with the legal requirements. In considering where to focus our resources on improving standards we will initially concentrate on the risks we have identified as posing the greatest threats to the effective governance and administration of public service schemes and legal requirements not being met, as well as the protection of member benefits where relevant.

We will ensure that any action we take is proportionate and evidence-based. While our key risk areas will be consistent across all public service schemes, what we consider to be tolerable at a particular point in time may vary. We will develop internal risk assessment processes, which will support our operational activity and ensure we are targeted and proportionate. We will ensure our approach to managing risk is proportionate and consistent by obtaining and analysing information from a variety of sources in order to maintain an informed strategic view across public service schemes. This will enable us to:

- ▶ swiftly detect patterns and causes of potential non-compliant behaviour, and
- ▶ establish and maintain effective risk assessment processes to direct and inform our activities.

<sup>2</sup> The Pensions Regulator is required to issue a code of practice relating to the following specific matters: i) Knowledge and understanding required by pension board members, ii) Conflicts of interest and representation, iii) Information to be published about schemes, iv) Internal controls, v) Scheme record-keeping, vi) Maintaining contributions, vii) Information to be provided to members, viii) Internal dispute resolution and ix) Reporting breaches of the law (section 90A of the 2004 Act).

## 2.2 Monitoring and reviewing our compliance activities

### Gathering information

In order to maintain an informed strategic view, we will identify, obtain and analyse information from a variety of sources, which may include:

- ▶ scheme returns
- ▶ enquiries and reports we receive
- ▶ media analysis
- ▶ horizon scanning
- ▶ intelligence reports
- ▶ internal and external research, and
- ▶ exchange of information with key parties.

We are required to maintain a register of scheme information which forms the bedrock of information about schemes. We will assist managers for new public service schemes which have arisen out of the new legislation, to meet the legal requirement to register with us and we plan to introduce a bespoke version of the statutory scheme return for all public service schemes. This will request 'registrable information'<sup>3</sup> (including information about the scheme, managers of the scheme and employers linked to the scheme) as well as other information which we may reasonably require to exercise our functions.

We plan to engage with schemes in the early stages of the new regulatory regime. While these interactions are primarily intended to enable schemes to raise standards of governance and administration and comply with the legal requirements, we will also gather information. This will be used to inform the risk-based prioritisation of our regulatory activities.

We will conduct an annual governance and administration survey with schemes to understand the extent to which they are meeting the standards and practices we expect. The first survey, which we plan to conduct in 2015, will comprise of a short online questionnaire. This will serve as an enablement tool for schemes and will help inform our risk assessment processes.

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<sup>3</sup> 'Registrable information' is certain information relating to a scheme specified in section 60 of the 2004 Act. Managers must provide this information when registering a scheme and keep it up to date. The regulator must ask for this information in scheme return notices and record it in the register of pension schemes.



### 2.2 Monitoring and reviewing our compliance activities continued...

Generally, we do not expect to specify how schemes should evidence any improvement activities, although we may seek or require information in a certain format on a case-by-case basis. Wherever possible, we will seek to make use of information that has already been gathered or reported by a scheme, to avoid duplication and unnecessary burdens. We will be proportionate in our activities, focusing on key areas that will help managers and others involved with public service schemes to improve governance and administration standards and comply with the law, and we will consistently work to minimise burdens on schemes.

#### **Reporting breaches of the law**

People involved in running or advising public service schemes are required by statute to report 'materially significant' breaches of the law to us under section 70 of the Pensions Act 2004. Those people include scheme managers, members of pension boards, anyone else involved in the administration of a scheme, employers, professional advisers and anyone who is otherwise involved in advising the scheme manager in relation to the scheme. Our public service code of practice provides guidance on how to assess 'material significance'.

We expect whistleblowers to follow our guidance on reporting breaches, which requires two key judgements:

1. Does the reporter have reasonable cause to believe there has been a breach of the law?
2. If so, does the reporter believe the breach is likely to be of material significance to The Pensions Regulator?

Receiving a report of a breach will not necessarily result in enforcement action. It may inform our education and enablement activities or the focus of a thematic review. In line with our risk framework, we will initially concentrate on the risks we have identified as posing the greatest threats to the effective governance and administration of public service schemes and legal requirements not being met, as well as the protection of member benefits where relevant. We will assess reports against a range of risk factors to determine the best course of action.

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## 2. Risk framework

### 2.2 Monitoring and reviewing our compliance activities continued...

Whistleblowing is an important component in our public service monitoring activity. We understand that when an individual provides information to us it may have a potential impact on the relationship between them and those to whom they report, particularly in the case of a scheme manager and member of a pension board. Individuals can always opt to report anonymously to us. However, having an individual's contact details is useful in case we need to ask for more information so we can investigate the concerns raised.

The Employment Rights Act 1996 provides certain protection for employees and workers making a whistleblowing disclosure to us. We will seek to protect a reporter's identity (if requested) and will not explicitly disclose the information except where lawfully required to do so. We will take all reasonable steps to maintain confidentiality, but we cannot give any categorical assurances as the circumstances may mean that the identity of a reporter becomes apparent during the course of an investigation, or we may be ordered by a court to disclose it. We will ensure that individuals who provide information have a specific point of contact and any witnesses are supported throughout our process.

## 2.3 Risk-based prioritisation

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

- ▶ **Knowledge and understanding<sup>4</sup>**  
Members of pension boards must comply with the requirement to have the appropriate knowledge and understanding, to be able to assist their scheme manager effectively. Failure to do so is a breach of law.
- ▶ **Conflicts of interest<sup>5</sup>**  
Scheme managers must ensure that pension board members do not have any conflicts of interest. A failure to do so is a breach of the law and could, for example, result in the advice and/or decisions of the pension board being open to challenge and, ultimately, the ineffective governance of the scheme.
- ▶ **Records<sup>6</sup>**  
Legislation specifies the records that must be kept and failure to comply is a breach of the law. The completeness and accuracy of these records will be key to the effective and efficient operation of schemes, including ensuring that the right benefits are paid to the right person at the right time. This will be supported by operating appropriate internal controls.
- ▶ **Internal controls<sup>7</sup>**  
Scheme managers must establish and operate internal controls. Failure to comply with this requirement is a breach of the law and it may also result in schemes not being run in accordance with the law and/or risks not being identified, mitigated and managed properly.
- ▶ **Member communication<sup>8</sup>**  
The quality of the information provided to members in terms of accuracy, timeliness and clarity is an important factor in achieving good member outcomes. Failure to comply with disclosure requirements is a breach of the law and may indicate incomplete or inaccurate record-keeping and/or inadequate internal controls.
- ▶ **Dealing with internal disputes<sup>9</sup>**  
Where we become aware of matters that are raised under internal dispute resolution procedures, this can be an indicator of wider systemic issues which may impact the effective governance and administration of schemes.

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As required under section 248A of the 2004 Act.

5

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

6

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

7

Section 249B of the 2004 Act.

8

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

9

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

## 2. Risk framework

### 2.2 Risk-based prioritisation continued...

In prioritising risk-based regulatory activities, we will consider factors such as schemes' ability and willingness to put matters right and the likely impact of the various types of intervention available to us.

We will adopt a 'test and learn' approach to investigations and regulatory action in relation to public service pension schemes. We plan to use a governance and administration survey, conducted in 2015, to baseline standards and monitor improvement in the following years. We will also learn through our early scheme engagements and feed that learning into the development of our risk-based approach.

## 3. Our activities to support compliance and enforcement

### 3.1 Education and enablement

In addition to Code of practice 14 providing practical guidance for schemes to support them to improve standards of governance and administration and comply with the legal requirements on how to comply with regulations, we will produce specific guidance for schemes through educational tools.

These will include e-learning modules aligned to the themes covered in code of practice 14, such as conflicts of interest, managing risk, internal controls and maintaining accurate member data.

We expect scheme managers and pension boards to make use of educational tools and products, whether they are products the regulator has provided, or others. This will help schemes address gaps in knowledge and understanding and assist in compliance. We will consider requests for us to attend training sessions for board members, although we will not lead these sessions.

The practical guidance in Code of practice 14 and the educational tools we have developed may also be used by employers and others to understand the legal requirements of the Public Service Pensions Acts and how their role may be relevant in helping scheme managers comply with them.

We will engage with scheme managers and pension boards to understand how they are addressing poor standards and non-compliance through the development and implementation of improvement plans, focusing on key risk areas.

We will encourage and facilitate those involved with different public service schemes to learn from each other via peer support, challenge networks and action learning sets. We will share best practice that we see as part of these engagements, working with scheme advisory boards, as appropriate, where they have a remit to promote best practice.

We plan to annually survey schemes to assess the extent to which they are meeting the standards and practices that we expect. We intend to publish the results of our surveys and encourage schemes to use the findings to review and refresh systems and controls, monitor risks and prioritise actions.

## 3.2 Thematic reviews

We will undertake thematic reviews, focusing on key risk areas, to gather information in relation to a particular issue or set of issues. The main purpose of these reviews will be to report back to our regulated community about best practice and risks. They will also improve our understanding of public service schemes and key risk areas, which will inform our activities and enable us to provide targeted and proportionate support.

Thematic reviews across all or part of the public service scheme landscape will be a particularly useful way for us to engage and communicate efficiently with the numerous scheme managers and pension boards of the locally administered schemes. Where appropriate, they will also enable us to engage and communicate with those to whom legal requirements or responsibilities relating to the management or administration of a public service pension scheme apply, or have been delegated or outsourced – for example, employers, administrators and professional advisers.

### Selecting a theme for review

We will select the theme for each review based on key risk areas and issues that are identified through different channels, including:

- ▶ educating and enabling activities
- ▶ enquiries and reports we receive
- ▶ horizon scanning
- ▶ intelligence reports
- ▶ information from key parties, which may include scheme advisory boards
- ▶ media analysis.

We may select a theme based on a particular risk area such as record-keeping or internal controls, in order to understand practices in a particular area and help us develop our ongoing regulatory work.

Alternatively, we may choose to focus a review on a particular segment of public service schemes – for example, funded or unfunded, locally or centrally administered schemes – or groups involved in the management or administration of schemes such as scheme managers, pension boards, employers or administrators.

### Participation in the review

Where we commence a review, we will expect scheme managers, pension boards and any other parties involved in the management or administration of public service schemes to respond to all requests for information or provide an explanation as to why they can't or won't supply the information. We expect to be able to gather the information on a voluntary basis, but if needed, we may also consider using our formal information-gathering powers under section 72 of the 2004 Act.

### 3.3 Enforcement

We may become aware of breaches of the law, or significant risks of breaches and a failure to address them, by any of the ways in which we gather information, as well as enquiries or reports we receive.

Actual or potential breaches may be identified via engagement with schemes, thematic reviews or reports. Where an actual or potential breach is identified, we will assess the risk and decide how to proceed.

We expect scheme managers, assisted by pension boards as appropriate, to:

- ▶ identify and understand the root causes of an issue which is resulting in poor standards of governance and administration and non-compliance with legal requirements
- ▶ develop an improvement plan which will address the root causes of that issue within a reasonable time period, and
- ▶ demonstrate implementation of their plan.

Generally, we expect to educate and enable scheme managers and pension board members, so they comply with legal requirements. However, where scheme managers or pension boards fail to address poor standards and non-compliance with the law within a reasonable time period, we will consider escalating our activities, undertaking further investigations and taking regulatory action where there has been a breach of pensions legislation. In certain circumstances we may consider it appropriate to go straight to enforcement action. Further information about how we undertake investigations, our powers and our decision-making process can be found in the Appendix on page 16.

A number of our powers extend to third parties such as employers, for example the power to provide information, education and assistance, or to issue third party notices when we believe a breach by a person is, wholly or partly, a result of a failure of another person.

# Appendix

## Our regulatory powers and decision-making process

### Undertaking investigations

Where we investigate, we may need to make some further enquiries to gather evidence, including for those schemes where we have already made information requests as part of a thematic review. This could include assessing the individual circumstances, the context of any breach of the law, any factors which may affect a decision to take enforcement action and the form that enforcement action might take.

We may seek information, documentation or an explanation from scheme managers and/or pension boards or any other relevant person. A reasonable period of time will be allowed for a response to be provided, taking into account the complexity and amount of information requested and the breach to which it relates.

Before making decisions, we may ask scheme managers and/or pension boards to provide us with information or other evidence of compliance with legal requirements. This may include (but is not limited to) copies of:

- ▶ pension board meeting minutes
- ▶ pension board training plans or logs
- ▶ registers of interest
- ▶ risk registers
- ▶ third party contracts and service level agreements
- ▶ scheme-approved policies and procedures
- ▶ stewardship reports
- ▶ statements of assurance
- ▶ audit reports
- ▶ annual reports and accounts.

continued over...



Appendix continued...

Undertaking investigations continued...

We may also contact other persons or third parties if we believe they may be in possession of relevant information or documents. These parties may include:

- ▶ third parties giving advice or providing business services to scheme managers and/or pension boards, and
- ▶ participating employers.

We may gather information through written requests, telephone calls or face-to-face meetings.

All information and evidence gathered during an investigation which amounts to personal data will be held securely and disposed of in accordance with the Data Protection Act 1998. We will disclose information only where we can lawfully do so and in line with the 2004 Act<sup>10</sup> and the Data Protection Act 1998, which govern the disclosure of information we receive in the exercise of our statutory functions.

Any investigation activity will only be undertaken when it is proportionate and reasonable to do so. We will record our decision-making and the justification for our actions and we will assess the risk of each case to ensure the appropriate course of action is taken. Investigations will be conducted in line with our legal obligations including compliance with the Human Rights Act 1998 and the Equality Act 2010.

continued over...

10  
Sections 82 to 87  
of the 2004 Act.

## Statutory information-gathering powers

While we expect to be able to gather information on a voluntary basis, where a person fails to respond to information requests without explanation, or we otherwise consider it necessary, we may consider using our formal information-gathering powers.

Under section 72 of the 2004 Act, we can require any person to provide information, or produce any documents in the manner, place and period as specified in the notice.

If we consider it necessary and to be a reasonable and proportionate way of obtaining the relevant information we need during an investigation, we can enter premises at any reasonable time (potentially including those of an employer or other third party) and conduct an inspection for the purpose of investigating whether scheme managers and pension boards have not complied, or are not complying, with certain legislative provisions, as set out under section 73(2) of the 2004 Act.

We may conduct an inspection where we have reason to believe the information could not be obtained under a section 72 request as the information or documents may be destroyed or altered. In these circumstances, we may decide to inspect premises without prior notice and arrive at premises unannounced.

Where a person does not have access to the documents or the information requested in the section 72 notices or they require a longer period in which to locate or gather together the requested information, they should tell us, otherwise sanctions may be imposed for non-compliance with the notice<sup>11</sup>. We will not refuse reasonable requests for an extension of time without good reason.

Where there is a failure to comply with a section 72 notice without reasonable excuse, we may consider criminal prosecution under section 77, or if false or misleading information is provided, under section 80 of the 2004 Act.

We may also consider the use of a 'Skilled Persons' report under section 71 of the 2004 Act. Provided the appropriate conditions are met, we may also use our powers to apply for a warrant under section 78 of the 2004 Act.

11  
Section 77 of  
the 2004 Act.

## Deciding whether to take enforcement action

Once we have completed our investigations, we will determine what, if any, action should be taken in relation to a particular breach of the law, including enforcement action where there has been a breach of pensions legislation. Where enforcement action is undertaken, we will follow our case team and Determinations Panel procedures<sup>12</sup> which describe how determinations on cases are made and how they can be appealed.

In deciding our approach and whether to take enforcement action in relation to a breach of pensions legislation, we will take into account factors such as the immediacy and materiality of the risk or issue, or the reaction of the parties involved. We will focus on the outcome that the action would provide.

The factors we will consider when deciding whether or not to take enforcement action will vary on a case-by-case basis. However, a key factor will be the extent to which scheme managers, assisted by pension boards as appropriate, have taken steps to:

- ▶ identify and understand the root causes of an issue which is resulting in poor standards of governance and administration and non-compliance with legal requirements
- ▶ develop an improvement plan which will address the root causes of that issue within a reasonable time period, and
- ▶ demonstrate implementation of their plan.

continued over...

12  
Available at: [www.tpr.gov.uk/procedures](http://www.tpr.gov.uk/procedures)

Deciding whether to take enforcement action continued...

Some general examples of other factors are provided below. These examples are not exhaustive, nor are they prescriptive or weighted in any way:

- ▶ The number of members affected.
- ▶ The extent to which there is a systemic problem.
- ▶ The financial impact on individual and/or groups of members.
- ▶ The severity and duration of the breach.
- ▶ Whether the breach could have easily been prevented.
- ▶ The degree to which practices relating to the breach in question are inconsistent with Code of practice 14.
- ▶ Whether the scheme manager or pension board has deliberately sought to conceal their non-compliant behaviour by giving false or misleading information to members and/or us.
- ▶ Whether members of pension boards are able to demonstrate that they have adequate knowledge and understanding and have training plans in place.
- ▶ Reaction of the scheme manager and pension board once the non-compliance has been brought to their attention. For example:
  - the speed and co-operation shown to resolve any issues brought to their attention
  - whether they accept responsibility for the non-compliance or demonstrate negative/non-compliant entrenched behaviours, and
  - willingness to engage and co-operate with us.
- ▶ The track record of the scheme manager and/or pension board in complying with their duties and obligations, and
- ▶ Evidence of dishonesty or wilful failures to comply.

## Deciding what enforcement action to take

Our enforcement options derive from legislation. We may select from one or more enforcement options, which range from statutory compliance notices and monetary penalties to criminal prosecution.

Our enforcement powers can variously be applied to scheme managers, members of pension boards, employers or third parties such as administrators. We will ensure that we act in accordance with all our legal obligations, including those contained within the Data Protection Act 1998 and Human Rights Act 1998.

### Statutory notices

If we believe that a breach of pensions legislation has occurred (as defined in section 13 of the 2004 Act) and that a statutory remedy is needed to secure compliance, we can issue statutory notices to scheme managers, pension board members or third parties, such as participating employers or outsourced payroll providers.

There are specific rules governing the use of different statutory notices. They may be used to direct a person to take, or not to take, specific actions within a specified timeframe. We will consider the circumstances in each case when deciding the most appropriate course to achieving compliance. We may consider the following interventions:

- ▶ Under section 13 of the 2004 Act, we may issue an Improvement Notice requiring specific action to be taken within a certain time, if a person has contravened pensions legislation. An Improvement Notice may direct compliance with a code of practice and will be preceded by a Warning Notice under section 96 of the 2004 Act.
- ▶ Under section 14 of the 2004 Act, we may issue a Third Party Notice requiring specific action to be taken (or to be refrained from being taken) within a certain time. This notice may be issued when we believe a contravention of pensions legislation is, wholly or partly, a result of a failure of another person (as defined in section 13 of the 2004 Act) and will be preceded by a Warning Notice under section 96 of the 2004 Act.

Non-compliance with a statutory notice may result in a penalty.

continued over...

### **Civil penalties**

We may impose a penalty under section 10 of the Pensions Act 1995. The maximum amount of a penalty in relation to each breach is £5,000 in the case of an individual and up to £50,000 in any other case.

### **Other statutory powers and orders**

We have a variety of statutory powers, which include the following:

- ▶ **Power to recover unpaid contributions**  
If an employer does not make a contribution payment towards an occupational or personal pension scheme on or before the due date, we may, on behalf of the scheme manager, exercise such powers as the scheme managers have to recover that contribution payable under section 17 of the 2004 Act.
- ▶ **Power to appoint a skilled person**  
Under section 14A of the 2004 Act, we can assist a pension board in the discharge of its functions where we consider it desirable for the purpose of ensuring compliance with pensions legislation (within the meaning given in section 13 of the 2004 Act). The pension board must have regard to the advice of the skilled person and their costs will be met by the scheme manager.

### **Publishing the outcome of activity**

We may publish reports of our regulatory activities in order to encourage learning and show lessons learned through our work. A decision to publish a report (under section 89 of the 2004 Act) will be taken on a case-by-case basis in line with our publication policy. We will usually engage with those directly involved in advance of publication.

Publishing the outcomes of our regulatory activities is an important way of encouraging improved standards and practices. Publication also raises awareness of the risks to the good governance and administration of schemes and should assist others in avoiding problems.

Publication also enables third parties to understand how their actions may have an impact on schemes. We put great emphasis on preventing problems from occurring, providing guidance to build good practice in collaboration with the regulated community.

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Free online learning for those running public service schemes

## Compliance and enforcement policy for public service pension schemes

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Code of practice no. 14

# **Governance and administration of public service pension schemes**

April 2015

The Pensions  
Regulator



Code of practice no. 14

## **Governance and administration of public service pension schemes**

Presented to Parliament pursuant to Section 91(5) of the Pensions Act 2004

Draft to lie before Parliament for forty days, during which time either House may resolve that the code be not made.

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12 January 2015

Code of practice no. 14

**Governance and administration of public service pension schemes**

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# Introduction

1. This code of practice is issued by The Pensions Regulator ('the regulator'), the body that regulates occupational and personal pension schemes provided through employers.
2. The regulator's statutory objectives<sup>1</sup> are to:
  - protect the benefits of pension scheme members
  - reduce the risks of calls on the Pension Protection Fund (PPF)
  - promote, and improve understanding of, the good administration of work-based pension schemes
  - maximise compliance with the duties and safeguards of the Pensions Act 2008
  - minimise any adverse impact on the sustainable growth of an employer (in relation to the exercise of the regulator's functions under Part 3 of the Pensions Act 2004 only).
3. The regulator has a number of regulatory tools, including issuing codes of practice, to enable it to meet its statutory objectives.
4. Codes of practice provide practical guidance in relation to the exercise of functions under relevant pensions legislation and set out the standards of conduct and practice expected from those who exercise those functions<sup>2</sup>.

## Status of codes of practice

5. Codes of practice are not statements of the law and there is no penalty for failing to comply with them. It is not necessary for all the provisions of a code of practice to be followed in every circumstance. Any alternative approach to that appearing in the code of practice will nevertheless need to meet the underlying legal requirements, and a penalty may be imposed if these requirements are not met. When determining whether the legal requirements have been met, a court or tribunal must take any relevant provisions of a code of practice into account<sup>3</sup>.
6. If there are grounds to issue an improvement notice<sup>4</sup>, the regulator may issue a notice directing a person to take, or refrain from taking, such steps as are specified in the notice. These directions may be worded by reference to a code of practice issued by the regulator<sup>5</sup>.

## This code of practice

7. The Public Service Pensions Act 2013 (the 2013 Act) introduces the framework for the governance and administration of public service pension schemes and provides an extended regulatory oversight by the regulator.

<sup>1</sup> Section 5(1) of the Pensions Act 2004.

<sup>2</sup> Section 90A(1), *ibid.*

<sup>3</sup> Section 90A(5), *ibid.*

<sup>4</sup> Where the regulator considers that legal requirements are not being met, or have been contravened in circumstances which make it likely that the breach will continue or be repeated, it may issue an improvement notice under s13 of the Pensions Act 2004.

<sup>5</sup> Section 13(3) of the Pensions Act 2004.

8. The regulator is required to issue one or more codes of practice covering specific matters relating to public service pension schemes<sup>6</sup>. This code of practice sets out the legal requirements for public service pension schemes in respect of those specific matters. It contains practical guidance and sets out standards of conduct and practice expected of those who exercise functions in relation to those legal requirements.
9. The practical guidance sections in this code are not intended to prescribe the process for every scenario. They do, however, provide principles, examples and benchmarks against which scheme managers and members of pension boards can consider whether or not they have understood their duties and obligations and are reasonably complying with them.
10. If scheme managers and the members of pension boards are, for any reason, unable to act in accordance with the guidance set out in this code, or an alternative approach that meets the underlying requirements, they should consider their statutory duty under section 70 of the Pensions Act 2004 to assess and if necessary report breaches of the law<sup>7</sup>. For further information, see the section of this code on 'Reporting breaches of the law'.

## At whom is this code directed?

11. This code relates to public service pension schemes within the meaning of the Pensions Act 2004<sup>8</sup>. These are schemes established under the 2013 Act, new public body pension schemes and other statutory pension schemes which are connected to those schemes. It does not apply to schemes in the wider public sector, nor to any scheme which is excluded from being a public service pension scheme within the meaning of the Pensions Act 2004.
12. This code is particularly directed at scheme managers and the members of pension boards of public service pension schemes and connected schemes. Scheme managers must comply with various legal requirements relating to the governance, management and administration of public service pension schemes. Pension boards must also comply with certain legal requirements, including assisting scheme managers in relation to securing compliance with scheme regulations and other legislation relating to the governance and administration of the scheme, any requirements of the regulator and with any other matters specified in scheme regulations. The role, responsibilities and duties of pension boards will vary. Where pension boards are not directly responsible for undertaking particular activities, they remain accountable for assisting the scheme manager in securing compliance with the scheme regulations and other legislation relating to the governance and administration of the scheme, any requirements of the regulator and with any other matters for which they are responsible under the scheme regulations<sup>9</sup>.

<sup>6</sup>  
Section 90A(2) of the Pensions Act 2004.

<sup>7</sup>  
Section 70, *ibid.*

<sup>8</sup>  
Section 318, *ibid.*

<sup>9</sup>  
Section 5 of the Public Service Pensions Act 2013.

13. In addition, the legal requirement to report breaches of the law under section 70 of the Pensions Act 2004 applies to other persons involved in public service pension schemes, so this code is also directed at them.
14. Scheme managers and pension boards (where relevant) may be able to delegate some activities to others, or outsource them, although they will not be able to delegate their accountability for complying with a legal requirement imposed on them. This code should therefore be followed by anyone to whom activities relating to the legal requirements covered by this code have been delegated or outsourced.
15. Employers participating in public service pension schemes will also find the code a useful source of reference. The role and actions of employers can be critical in enabling scheme managers to meet certain legal requirements<sup>10</sup>.
16. Public service pension schemes are established primarily as defined benefit (DB) schemes. Some of these schemes also enable members to make additional voluntary contributions (AVCs) on either a DB basis or to a separate defined contribution (DC) scheme. There are also some DC schemes which are offered as alternatives to the DB schemes. This code applies to any DC scheme which is a public service pension scheme within the meaning of the Pensions Act 2004.

## Terms used in this code

17. **The 2013 Act** – the Public Service Pensions Act 2013, which sets out the arrangements for the creation of schemes for the payment of pensions and other benefits. It provides powers to ministers to create such schemes according to a common framework of requirements.
18. **Public service pension schemes**<sup>11</sup> – these are (a) new public service pension schemes set up under section 1 of the 2013 Act (including any scheme which has effect as such a scheme<sup>12</sup>); (b) new public body pension schemes (within the meaning of the 2013 Act) and (c) any statutory pension schemes connected with a scheme described in (a) or (b). Substantially, these are the schemes providing pension benefits for civil servants, the judiciary, local government workers, teachers, health service workers, fire and rescue workers, members of police forces and the armed forces. Except where specified otherwise, the legal requirements and practical guidance set out in this code apply to any kind of public service pension scheme within the meaning of the Pensions Act 2004, whether it is a scheme established under section 1 of the 2013 Act, a new public body scheme or a connected scheme.

10  
Employers participating in occupational public service pension schemes are under a statutory duty to report breaches of the law under s70 of the Pensions Act 2004.

11  
As defined in s318 of the Pensions Act 2004. Under s318(6) of that Act, a scheme which would otherwise fall within the definition of 'public service pension scheme' in the Pensions Act 2004 does not do so if it is a scheme providing only for injury or compensation benefits (or both), or if it is specified in an order made under that section.

12  
Section 28 of the 2013 Act.



19. **Connected scheme** – a scheme established under section 1 of the 2013 Act and another statutory pension scheme, or a new public body pension scheme and another statutory pension scheme are connected if and to the extent that the schemes make provision in relation to persons of the same description. Scheme regulations may specify exceptions<sup>13</sup>.
20. **Responsible authority** – the 2013 Act identifies secretaries of state/ ministers, each being the responsible authority for their schemes, who have power to make the scheme regulations for the relevant schemes<sup>14</sup>. The responsible authority may also be the scheme manager<sup>15</sup>. In relation to a public body pension scheme, references in the code to the responsible authority are to be read as references to the public authority which established the scheme.
21. **Scheme regulations** – each new scheme made under section 1 of the 2013 Act has scheme regulations which set out the detail of the membership and benefits to be provided under the scheme<sup>16</sup>. The regulations must identify scheme managers and provide for the establishment of pension boards and scheme advisory boards. These regulations constitute the main rules of the scheme. In addition to the scheme regulations, the rules of a scheme include:

- certain legislative provisions, to the extent that they override provisions of the scheme regulations, or which have effect in relation to a scheme and are not otherwise reflected in the scheme regulations, and
- any provision which the scheme regulations do not contain but which the scheme rules must contain if it is to conform with the requirements of Chapter 1 of Part 4 of the Pension Schemes Act 1993 (preservation of benefit under occupational pension schemes)<sup>17</sup>.

Some connected schemes and new public body pension schemes will not be established by regulations, so references in the code to scheme regulations should be read as references to the rules of the scheme in these cases.

22. **Scheme manager** – each public service pension scheme has one or more persons responsible for managing or administering the scheme<sup>18</sup>. Public service pension schemes can have different persons acting as scheme manager for different parts of the pension scheme. For the locally administered schemes<sup>19</sup>, the scheme managers may be the local administering authorities or a person representing an authority or police force.

13  
Section 4(6) and (7) of the 2013 Act.

14  
Section 2 and Schedule 2, *ibid.*

15  
Section 4(3), *ibid.*

16  
Section 3 and Schedule 3, *ibid.*

17  
Section 318(2) of the Pensions Act 2004.

18  
Section 4 and s30 of the 2013 Act.

19  
Locally administered schemes include the schemes for England, and Wales, and Scotland for local government workers, and England and Wales for fire and rescue workers and members of police forces.

23. **Pension board** – the scheme manager (or each scheme manager) for a scheme has a pension board<sup>20</sup> with responsibility for assisting the scheme manager to comply with the scheme regulations and other legislation relating to the governance and administration of the scheme and any requirements imposed by the regulator. The pension board must also assist the scheme manager with such other matters as the scheme regulations may specify. It will be for scheme regulations and the scheme manager to determine precisely what the pension board’s role, responsibilities and duties entail.
24. **Scheme advisory board** – each DB public service pension scheme has a scheme advisory board<sup>21</sup> with responsibility for providing advice on the desirability of changes to the scheme, when requested to do so by the responsible authority (or otherwise, in accordance with scheme regulations). Where there is more than one scheme manager the scheme regulations may also provide for the scheme advisory board to provide advice (on request or otherwise) to the scheme managers or the scheme’s pension boards on the effective and efficient administration and management of the scheme or any pension fund of the scheme.
25. **Schemes** – in this code the term ‘schemes’ is used throughout where actions to comply with a legal requirement, standard or expectation may be carried out by the scheme manager, pension board or by another person(s) including those to whom activities have been delegated or outsourced. The scheme manager or pension board will be ultimately accountable, depending upon to whom the legal obligation applies under the legislation.
26. **Must** – in this code the term ‘must’ is used where there is a legal requirement.
27. **Should** – in this code the term ‘should’ is used to refer to practical guidance and the standards expected by the regulator.

## How to use this code

28. The code is structured as a reference for scheme managers and pension boards to use to inform their actions in four core areas of scheme governance and administration: governing your scheme, managing risks, administration and resolving issues.
29. Each core section includes practical guidance to help scheme managers and pension boards to discharge their legal duties. The regulator recognises that there may be alternative and justifiable actions or approaches that scheme managers or pension boards may wish to adopt, provided these meet the minimum legal requirements.
30. Schemes will need to consider and apply the practical guidance to suit their own particular characteristics and arrangements.

20  
Section 5 and s30(1) of the 2013 Act (in the case of new public body schemes, if the scheme has more than one member).

21  
Section 7, *ibid*. This requirement only applies to schemes set up under s1 of the 2013 Act.

## Northern Ireland

31. References to the law that applies in Great Britain should be taken to include corresponding legislation in Northern Ireland. References to HM Treasury directions should be taken to be directions by the Department of Finance and Personnel. The responsible authority for each scheme is the relevant government department<sup>22</sup>.
32. The appendix to this code lists the corresponding references to Northern Ireland legislation.

22  
Section 2 and Schedule  
2 of the Public Service  
Pensions Act (Northern  
Ireland) 2014.

# Governing your scheme

33. This part of the code covers:

- knowledge and understanding required by pension board members
- conflicts of interest and representation, and
- publishing information about schemes.

## Knowledge and understanding required by pension board members

### Legal requirements

34. A member of the pension board of a public service pension scheme must be conversant with:

- the rules of the scheme<sup>23</sup>, and
- any document recording policy about the administration of the scheme which is for the time being adopted in relation to the scheme.

35. A member of a pension board must have knowledge and understanding of:

- the law relating to pensions, and
- any other matters which are prescribed in regulations.

36. The degree of knowledge and understanding required is that appropriate for the purposes of enabling the individual to properly exercise the functions of a member of the pension board<sup>24</sup>.

### Practical guidance

37. The legislative requirements about knowledge and understanding only apply to pension board members. However, scheme managers should take account of this guidance as it will support them in understanding the legal framework and enable them to help pension board members to meet their legal obligations.

38. Schemes<sup>25</sup> should establish and maintain policies and arrangements for acquiring and retaining knowledge and understanding to support their pension board members. Schemes should designate a person to take responsibility for ensuring that a framework is developed and implemented.

39. However, it is the responsibility of individual pension board members to ensure that they have the appropriate degree of knowledge and understanding to enable them to properly exercise their functions as a member of the pension board.

23

See paragraph 21 for the definition of the 'rules of the scheme'.

24

Section 248A of the Pensions Act 2004.

25

See paragraph 25 for the definition of 'schemes'.

## Areas of knowledge and understanding required

40. Pension board members must be conversant with their scheme rules, which are primarily found in the scheme regulations<sup>26</sup>, and documented administration policies currently in force for their pension scheme<sup>27</sup>. Being 'conversant' means having a working knowledge of the scheme regulations and policies, so that pension board members can use them effectively when carrying out their duties.
41. They must also have knowledge and understanding of the law relating to pensions (and any other matters prescribed in legislation) to the degree appropriate for them to be able to carry out their role, responsibilities and duties.
42. In terms of documented administration policies, specific documents recording policy about administration will vary from scheme to scheme. However, the following are examples of administration policies which the regulator considers to be particularly pertinent and would expect to be documented where relevant to a pension scheme, and with which pension board members must therefore be conversant where applicable<sup>28</sup>. This list is not exhaustive and other documented policies may fall into this category:
  - any scheme-approved policies relating to:
    - conflicts of interest and the register of interests
    - record-keeping
    - internal dispute resolution
    - reporting breaches
    - maintaining contributions to the scheme
    - the appointment of pension board members
  - risk assessments/management and risk register policies for the scheme
  - scheme booklets, announcements and other key member and employer communications, which describe scheme policies and procedures
  - the roles, responsibilities and duties of the scheme manager, pension board and individual pension board members
  - terms of reference, structure and operational policies of the pension board and/or any sub-committee
  - statements of policy about the exercise of discretionary functions

<sup>26</sup>  
See paragraph 21 for the definition of the 'rules of the scheme'.

<sup>27</sup>  
Section 248A(2) of the Pensions Act 2004.

<sup>28</sup>  
Section 248A(2)(b) of the Pensions Act 2004.

- statements of policy about communications with members and scheme employers
  - the pension administration strategy, or equivalent<sup>29</sup>, and
  - any admission body (or equivalent) policies.
43. For pension board members of funded pension schemes, documents which record policy about the administration of the scheme will include those relating to funding and investment matters. For example, where relevant they must be conversant with the statement of investment principles and the funding strategy statement<sup>30</sup>.
44. Pension board members must also be conversant with any other documented policies relating to the administration of the scheme. For example, where applicable, they must be conversant with policies relating to:
- the contribution rate or amount (or the range/variability where there is no one single rate or amount) payable by employers participating in the scheme
  - statements of assurance (for example, assurance reports from administrators)
  - third party contracts and service level agreements
  - stewardship reports from outsourced service providers (for example, those performing outsourced activities such as scheme administration), including about compliance issues
  - scheme annual reports and accounts
  - accounting requirements relevant to the scheme
  - audit reports, including from outsourced service providers, and
  - other scheme-specific governance documents.
45. Where DC or DC AVC options are offered, pension board members should also be familiar with the requirements for the payment of member contributions to the providers, the principles relating to the operation of those arrangements, the choice of investments to be offered to members, the provider's investment and fund performance report and the payment schedule for such arrangements.
46. Schemes should prepare and keep an updated list of the documents with which they consider pension board members need to be conversant. This will enable them to effectively carry out their role. They should make sure that both the list and the documents are available in accessible formats.

<sup>29</sup>  
For the local government pension schemes, this might include information about the setting of performance targets or making agreements about levels of performance.

<sup>30</sup>  
Section 248A(2)(b) of the Pensions Act 2004.

## Degree of knowledge and understanding required

47. The roles, responsibilities and duties of pension boards and their individual members will vary between pension schemes. Matters for which the pension board is responsible will be set out in scheme regulations<sup>31</sup>. Clear guidance on the roles, responsibilities and duties of pension boards and the members of those boards should be set out in scheme documentation.
48. Schemes should assist individual pension board members to determine the degree of knowledge and understanding that is sufficient for them to effectively carry out their role, responsibilities and duties as a pension board member.
49. Pension board members must have a working knowledge of their scheme regulations and documented administration policies. They should understand their scheme regulations and policies in enough detail to know where they are relevant to an issue and where a particular provision or policy may apply.
50. Pension board members must have knowledge and understanding of the law relating to pensions (and any other prescribed matters) sufficient for them to exercise the functions of their role. Pension board members should be aware of the range and extent of the law relating to pensions which applies to their scheme, and have sufficient understanding of the content and effect of that law to recognise when and how it impacts on their responsibilities and duties.
51. Pension board members should be able to identify and where relevant challenge any failure to comply with:
  - the scheme regulations
  - other legislation relating to the governance and administration of the scheme
  - any requirements imposed by the regulator, or
  - any failure to meet the standards and expectations set out in any relevant codes of practice issued by the regulator.
52. Pension board members' breadth of knowledge and understanding should be sufficient to allow them to understand fully and challenge any information or advice they are given. They should understand how that information or advice impacts on any issue or decision relevant to their responsibilities and duties.

31  
Section 5(2) of the 2013  
Act.

53. Pension board members of funded pension schemes should ensure that they have the appropriate degree of knowledge and understanding of funding and investment matters relating to their scheme to enable them to effectively carry out their role. This includes having a working knowledge of provisions in their scheme regulations and administration policies that relate to funding and investment, as well as knowledge and understanding of relevant law relating to pensions.
54. All board members should attain appropriate knowledge so that they are able to understand the relevant law in relation to their scheme and role. The degree of knowledge and understanding required of pension board members may vary according to the role of the board member, as well as the expertise of the board member. For example, a board member who is also a pensions law expert (for instance, as a result of their day job) should have a greater level of knowledge than that considered appropriate for board members without this background.

### **Acquiring, reviewing and updating knowledge and understanding**

55. Pension board members should invest sufficient time in their learning and development alongside their other responsibilities and duties. Schemes should provide pension board members with the relevant training and support that they require. Training is an important part of the individual's role and will help to ensure that they have the necessary knowledge and understanding to effectively meet their legal obligations.
56. Newly appointed pension board members should be aware that their responsibilities and duties as a pension board member begin from the date they take up their post. Therefore, they should immediately start to familiarise themselves with the scheme regulations, documents recording policy about the administration of the scheme and relevant pensions law. Schemes should offer pre-appointment training or arrange for mentoring by existing pension board members. This can also ensure that historical and scheme-specific knowledge is retained when pension board members change.
57. Pension board members should undertake a personal training needs analysis and regularly review their skills, competencies and knowledge to identify gaps or weaknesses. They should use a personalised training plan to document and address these promptly.



58. Learning programmes should be flexible, allowing pension board members to update particular areas of learning where required and to acquire new areas of knowledge in the event of any change. For example, pension board members who take on new responsibilities will need to ensure that they gain appropriate knowledge and understanding relevant to carrying out those new responsibilities.
59. The regulator will provide an e-learning programme to help meet the needs of pension board members, whether or not they have access to other learning. If schemes choose alternative learning programmes they should be confident that those programmes:
- cover the type and degree of knowledge and understanding required
  - reflect the legal requirements, and
  - are delivered within an appropriate timescale.

## Demonstrating knowledge and understanding

60. Schemes should keep appropriate records of the learning activities of individual pension board members and the board as a whole. This will help pension board members to demonstrate steps they have taken to comply with legal requirements and how they have mitigated risks associated with knowledge gaps. A good external learning programme will maintain records of the learning activities of individuals on the programme or of group activities, if these have taken place.

## Conflicts of interest and representation

### Legal requirements

61. A conflict of interest is a financial or other interest which is likely to prejudice a person's exercise of functions as a member of the pension board. It does not include a financial or other interest arising merely by virtue of that person being a member of the scheme or any connected scheme for which the board is established<sup>32</sup>.
62. In relation to the pension board, scheme regulations must include provision requiring the scheme manager to be satisfied:
- that a person to be appointed as a member of the pension board does not have a conflict of interest and
  - from time to time, that none of the members of the pension board has a conflict of interest<sup>33</sup>.

32  
Section 5(5) of the 2013 Act defines a conflict of interest in relation to pension board members and s7(5) of that Act in relation to scheme advisory board members.

33  
Section 5(4)(a), *ibid.*

63. Scheme regulations must require each member or proposed member of a pension board to provide the scheme manager with such information as the scheme manager reasonably requires for the purposes of meeting the requirements referred to above<sup>34</sup>.
64. Scheme regulations must include provision requiring the pension board to include employer representatives and member representatives in equal numbers<sup>35</sup>.
65. In relation to the scheme advisory board, the regulations must also include provision requiring the responsible authority to be satisfied:
  - that a person to be appointed as a member of the scheme advisory board does not have a conflict of interest and
  - from time to time, that none of the members of the scheme advisory board has a conflict of interest<sup>36</sup>.
66. Scheme regulations must require each member of a scheme advisory board to provide the responsible authority with such information as the responsible authority reasonably requires for the purposes of meeting the requirements referred to above<sup>37</sup>.

## Practical guidance

67. This guidance is to help scheme managers to meet the legal requirement to be satisfied that pension board members do not have any conflicts of interest. The same requirements apply to responsible authorities in relation to scheme advisory boards, (apart from the requirement regarding employer and member representatives), but the regulator does not have specific responsibility for oversight of scheme advisory boards.
68. Actual conflicts of interest are prohibited by the 2013 Act and cannot, therefore, be managed. Only potential conflicts of interest can be managed.
69. A conflict of interest may arise when pension board members:
  - must fulfil their statutory role<sup>38</sup> of assisting the scheme manager in securing compliance with the scheme regulations, other legislation relating to the governance and administration of the scheme and any requirements imposed by the regulator or with any other matter for which they are responsible, whilst
  - having a separate personal interest (financial or otherwise), the nature of which gives rise to a possible conflict with their statutory role.

34  
Section 5(4)(b) of the  
2013 Act.

35  
Section 5(4)(c), *ibid.*

36  
Section 7(4)(a), *ibid.*

37  
Section 7(4)(b), *ibid.*

38  
Section 5(2), *ibid.*

70. Some, if not all, of the 'Seven principles of public life' (formerly known as the 'Nolan principles')<sup>39</sup> will already apply to people carrying out roles in public service pension schemes, for example through the Ministerial code, Civil Service code or other codes of conduct. These principles should be applied to all pension board members in the exercise of their functions as they require the highest standards of conduct. Schemes should incorporate the principles into any codes of conduct (and across their policies and processes) and other internal standards for pension boards.
71. Other legal requirements relating to conflicts of interest may apply to pension board members and/or scheme advisory board members<sup>40</sup>. The regulator may not have specific responsibility for enforcing all such legal requirements, but it does have a particular role in relation to pension board members and conflicts of interest. While pension board members may be subject to other legal requirements, when exercising functions as a member of a pension board they must meet the specific requirements of the 2013 Act and are expected to satisfy the standards of conduct and practice set out in this code.
72. It is likely that some pension board members will have dual interests, which may include other responsibilities. Scheme managers and pension board members will need to consider all other interests, financial or otherwise, when considering interests which may give rise to a potential or actual conflict. For example, a finance officer appointed as a pension board member can offer their knowledge and make substantial contributions to the operational effectiveness of the scheme, but from time to time they may be involved in a decision or matter which may be, or appear to be, in opposition to another interest. For instance, the pension board may be required to take or scrutinise a decision which involves the use of departmental resources to improve scheme administration, while the finance officer is at the same time tasked, by virtue of their employment, with reducing departmental spending. A finance officer might not be prevented from being a member of a pension board, but the scheme manager must be satisfied that their dual interests are not likely to prejudice the pension board member in the exercise of any particular function.

39  
The Committee on Standards in Public Life has set out seven principles of public life which apply to anyone who works as a public office holder or in other sectors delivering public services:  
[www.gov.uk/government/publications/the-7-principles-of-public-life](http://www.gov.uk/government/publications/the-7-principles-of-public-life).

40  
For example, local government legislation applicable to English local authorities contains legal requirements relating to certain people about standards of conduct, conflicts of interest and disclosure of certain interests.

73. Scheme regulations will set out matters for which the pension board is responsible<sup>41</sup>. Schemes<sup>42</sup> should set out clear guidance on the roles, responsibilities and duties of pension boards and the members of those boards in scheme documentation. This should cover, for example, whether they have responsibility for administering or monitoring the administration of the scheme; developing, delivering or overseeing compliance with requirements for governance and/or administration policies; and taking or scrutinising decisions relating to governance and/or administration. Regardless of their remit, potential conflicts of interest affecting pension board members need to be identified, monitored and managed effectively.
74. Schemes should consider potential conflicts of interest in relation to the full scope of roles, responsibilities and duties of pension board members. It is recommended that all those involved in the management or administration of public service pension schemes take professional legal advice when considering issues to do with conflicts of interest.

### **A three-stage approach to managing potential conflicts of interest**

75. Conflicts of interest can inhibit open discussions and result in decisions, actions or inactions which could lead to ineffective governance and administration of the scheme. They may result in pension boards acting improperly, or lead to a perception that they have acted improperly. It is therefore essential that any interests, which have the potential to become conflicts of interest or be perceived as conflicts of interest, are identified and that potential conflicts of interest (including perceived conflicts) are monitored and managed effectively.
76. Schemes should ensure that there is an agreed and documented conflicts policy and procedure, which includes identifying, monitoring and managing potential conflicts of interest. They should keep this under regular review. Policies and procedures should include examples of scenarios giving rise to conflicts of interest, how a conflict might arise specifically in relation to a pension board member and the process that pension board members and scheme managers should follow to address a situation where board members are subject to a potential or actual conflict of interest.

41  
Section 5(2) of the 2013 Act.

42  
See paragraph 25 for the definition of 'schemes'.

77. Broadly, schemes should consider potential conflicts of interest in three stages:
- identifying
  - monitoring, and
  - managing.

### Identifying potential conflicts

78. Schemes should cultivate a culture of openness and transparency. They should recognise the need for continual consideration of potential conflicts. Disclosure of interests which have the potential to become conflicts of interest should not be ignored. Pension board members should have a clear understanding of their role and the circumstances in which they may find themselves in a position of conflict of interest. They should know how to manage potential conflicts.
79. Pension board members, and people who are proposed to be appointed to a pension board, must provide scheme managers with information that they reasonably require to be satisfied that pension board members and proposed members do not have a conflict of interest<sup>43</sup>.
80. Schemes should ensure that pension board members are appointed under procedures that require them to disclose any interests, including other responsibilities, which could become conflicts of interest and which may adversely affect their suitability for the role, before they are appointed.
81. All terms of engagement, for example appointment letters, should include a clause requiring disclosure of all interests, including any other responsibilities, which have the potential to become conflicts of interest, as soon as they arise. All interests disclosed should be recorded. See the section of this code on 'Monitoring potential conflicts'.
82. Schemes should take time to consider what important matters or decisions are likely to be considered during, for example, the year ahead and identify and consider any potential or actual conflicts of interest that may arise in the future. Pension board members should be notified as soon as practically possible and mitigations should be put in place to prevent these conflicts from materialising.

43  
Section 5(4)(b) of the  
2013 Act and scheme  
regulations.

## Monitoring potential conflicts

83. As part of their risk assessment process, schemes should identify, evaluate and manage dual interests which have the potential to become conflicts of interest and pose a risk to the scheme and possibly members, if they are not mitigated. Schemes should evaluate the nature of any dual interests and assess the likely consequences were a conflict of interest to materialise.
84. A register of interests should provide a simple and effective means of recording and monitoring dual interests and responsibilities. Schemes should also capture decisions about how to manage potential conflicts of interest in their risk registers or elsewhere. The register of interests and other relevant documents should be circulated to the pension board for ongoing review and published, for example on a scheme's website.
85. Conflicts of interest should be included as an opening agenda item at board meetings and revisited during the meeting, where necessary. This provides an opportunity for those present to declare any interests, including other responsibilities, which have the potential to become conflicts of interest, and to minute discussions about how they will be managed to prevent an actual conflict arising.

## Managing potential conflicts

86. Schemes should establish and operate procedures which ensure that pension boards are not compromised by potentially conflicted members. They should consider and determine the roles and responsibilities of pension boards and individual board members carefully to ensure that conflicts of interest do not arise, nor are perceived to have arisen.
87. A perceived conflict of interest can be as damaging to the reputation of a scheme as an actual conflict of interest. It could result in scheme members and interested parties losing confidence in the way a scheme is governed and administered. Schemes should be open and transparent about the way they manage potential conflicts of interest.
88. When seeking to prevent a potential conflict of interest becoming detrimental to the conduct or decisions of the pension board, schemes should consider obtaining professional legal advice when assessing any option.

## Examples of conflicts of interest

89. Below are some examples of potential or actual conflicts of interest which could arise, or be perceived to arise, in relation to public service pension schemes. These will depend on the precise role, responsibilities and duties of a pension board. The examples provided are for illustrative purposes only and are not exhaustive. They should not be relied upon as a substitute for the exercise of judgement based on the principles set out in this code and any legal advice considered appropriate, on a case-by-case basis.

### **a. Investing to improve scheme administration versus saving money**

An employer representative, who may be a Permanent Secretary, finance officer or local councillor, is aware that system X would help to improve standards of record-keeping in the scheme, but it would be costly to implement. The scheme manager, for instance a central government department or local administering authority, would need to meet the costs of the new system at a time when there is internal and external pressure to keep costs down. In order to meet the costs of the new system, the scheme manager would need to find money, perhaps by using a budget that was intended for another purpose. This decision could prove unpopular with taxpayers. A conflict of interest could arise where the employer representative was likely to be prejudiced in the exercise of their functions by virtue of their dual interests.

### **b. Outsourcing an activity versus keeping an activity in-house**

In an extension of the previous example, a member representative, who is also an employee of a participating employer, is aware that system X would help to improve standards of record-keeping in the scheme, but it would mean outsourcing an activity that is currently being undertaken in-house by their employer. The member representative could be conflicted if they were likely to be prejudiced in the exercise of their functions by virtue of their employment.

### **c. Representing the breadth of employers or membership versus representing narrow interests**

An employer representative who happens to be employed by the administering authority and is appointed to the pension board to represent employers generally could be conflicted if they only serve to act in the interests of the administering authority, rather than those of all participating employers. Equally, a member representative, who is also a trade union representative, appointed to the pension board to represent the entire scheme membership could be conflicted if they only act in the interests of their union and union membership, rather than all scheme members.

#### **d. Assisting the scheme manager versus furthering personal interests**

- i. A pension board member, who is also a scheme adviser, may recommend the services or products of a related party, for which they might derive some form of benefit, resulting in them not providing, or not being seen to provide, independent advice or services
- ii. A pension board member who is involved in procuring or tendering for services for a scheme administrator, and who can influence the award of a contract, may be conflicted where they have an interest in a particular supplier, for example, a family member works there.

#### **e) Sharing information with the pension board versus a duty of confidentiality to an employer**

An employer representative has access to information by virtue of their employment, which could influence or inform the considerations or decisions of the pension board. They have to consider whether to share this information with the pension board in light of their duty of confidentiality to their employer. Their knowledge of this information will put them in a position of conflict if it is likely to prejudice their ability to carry out their functions as a member of the pension board.

## **Representation on pension boards**

90. While scheme regulations must require pension boards to have an equal number of employer and member representatives<sup>44</sup>, there is flexibility to design arrangements which best suit each scheme.
91. Arrangements should be designed with regard to the principles of proportionality, fairness and transparency, and with the aim of ensuring that a pension board has the right balance of skills, experience and representation (for example, of membership categories and categories of employers participating in the scheme). Those responsible for appointing members to a pension board should also consider the mix of skills and experience needed on the pension board in order for the board to operate effectively in light of its particular role, responsibilities and duties.

44  
Section 5(4)(c) of the  
2013 Act.



## Publishing information about schemes

### Legal requirements

92. The scheme manager for a public service scheme must publish information about the pension board for the scheme(s) and keep that information up-to-date<sup>45</sup>.
93. The information must include:
  - who the members of the pension board are
  - representation on the board of members of the scheme(s), and
  - the matters falling within the pension board's responsibility<sup>46</sup>.

### Practical guidance

#### Publication of pension board information

94. Scheme members will want to know that their scheme is being efficiently and effectively managed. Public service pension schemes should have a properly constituted, trained and competent pension board, which is responsible for assisting the scheme manager to comply with the scheme regulations and other legislation relating to the governance and administration of the scheme and requirements imposed by the regulator.
95. Scheme managers must publish the information required about the pension board and keep that information up-to-date<sup>47</sup>. This will ensure that scheme members can easily access information about who the pension board members are, how pension scheme members are represented on the pension board and the responsibilities of the board as a whole.
96. When publishing information about the identity of pension board members, the representation of scheme members and matters for which the board is responsible, schemes<sup>48</sup> should also publish useful related information about the pension board such as:
  - the employment and job title (where relevant) and any other relevant position held by each board member
  - the pension board appointment process
  - who each pension board member represents
  - the full terms of reference for the pension board, including details of how it will operate, and
  - any specific roles and responsibilities of individual pension board members.

45  
Section 6(1) of the 2013 Act.

46  
Section 6(2), *ibid.*

47  
Section 6(1), *ibid.*

48  
See paragraph 25 for the definition of 'schemes'.

97. Schemes should also consider publishing information about pension board business, for example board papers, agendas and minutes of meetings (redacted to the extent that they contain confidential information and/or data covered by the Data Protection Act 1998). They should consider any requests for additional information to be published, to encourage scheme member engagement and promote a culture of transparency.
98. Scheme managers must ensure that information published about the pension board is kept up-to-date<sup>49</sup>. Schemes should have policies and processes to monitor all published data on an ongoing basis to ensure it is accurate and complete.

## Other legal requirements

99. Scheme managers (or any other person specified in legislation) must comply with any other legal requirements relating to the publication of information about governance and administration. In particular, HM Treasury directions may require the scheme manager or responsible authority of a public service pension scheme to publish scheme information, including information about scheme administration and governance and may specify how and when information is to be published<sup>50</sup>.

49  
Section 6(1) of the 2013  
Act.

50  
Section 15, *ibid.*

# Managing risks

100. This part of the code covers the requirement for scheme managers to establish and operate adequate internal controls.

## Internal controls

### Legal requirements

101. The scheme manager of a public service pension scheme must establish and operate internal controls. These must be adequate for the purpose of securing that the scheme is administered and managed in accordance with the scheme rules and in accordance with the requirements of the law.

102. For these purposes 'internal controls' means:

- arrangements and procedures to be followed in the administration and management of the scheme
- systems and arrangements for monitoring that administration and management, and
- arrangements and procedures to be followed for the safe custody and security of the assets of the scheme<sup>51</sup>.

### Practical guidance

103. Internal controls are systems, arrangements and procedures that are put in place to ensure that pension schemes are being run in accordance with the scheme rules (which for most public service pension schemes are set out in the scheme regulations) and other law. They should include a clear separation of duties, processes for escalation and decision making and documented procedures for assessing and managing risk, reviewing breaches of law and managing contributions to the scheme.

104. Good internal controls are an important characteristic of a well-run scheme and one of the main components of the scheme manager's role in securing the effective governance and administration of the scheme. Internal controls can help protect pension schemes from adverse risks, which could be detrimental to the scheme and members if they are not mitigated.

105. Scheme managers must establish and operate internal controls<sup>52</sup>. These should address significant risks which are likely to have a material impact on the scheme. Scheme managers should employ a risk-based approach and ensure that sufficient time and attention is spent on identifying, evaluating and managing risks and developing and monitoring appropriate controls. They should seek advice, as necessary.

<sup>51</sup> Section 249A(5) and s249B of the Pensions Act 2004.

<sup>52</sup> Section 249B, *ibid.*

## Identifying risks

106. Before implementing an internal controls framework, schemes<sup>53</sup> should carry out a risk assessment. They should begin by:
- setting the objectives of the scheme
  - determining the various functions and activities carried out in the running of the scheme, and
  - identifying the main risks associated with those objectives, functions and activities.
107. An effective risk assessment process will help schemes to identify a wide range of internal and external risks, which are critical to the scheme and members. When identifying risks, schemes should refer to relevant sources of information, such as records of internal disputes and legislative breaches, the register of interests, internal and external audit reports and service contracts.
108. Once schemes have identified risks, they should record them in a risk register and review them regularly. Schemes should keep appropriate records to help scheme managers demonstrate steps they have taken to comply, if necessary, with legal requirements.

## Evaluating risks and establishing adequate internal controls

109. Not all risks will have the same potential impact on scheme operations and members or the same likelihood of materialising. Schemes should consider both these areas when determining the order of priority for managing risks and focus on those areas where the impact and likelihood of a risk materialising is high.
110. Many pension schemes will already have adequate internal controls in place, some of which may apply to a variety of the functions of the administering authority. Schemes should review their existing arrangements and procedures to determine whether they can prevent and detect errors in scheme operations and help mitigate pension scheme-related risks. For example, schemes could obtain assurance about their existing controls through direct testing or by obtaining reports on controls. Any such review should be appropriate to the outcome of the risk evaluation.
111. Schemes should consider what internal controls are appropriate to mitigate the main risks they have identified and how best to monitor them. For example, the scheme manager(s) for a funded scheme should establish and operate internal controls that regularly assess the effectiveness of investment-related decision making. Scheme managers for all pension schemes should establish and operate internal controls that regularly assess the effectiveness of data management and record-keeping.

53  
See paragraph 25 for the definition of 'schemes'.

## Managing risks by operating internal controls

112. Schemes should consider a number of issues when designing internal controls to manage risks. The examples provided are for illustrative purposes only and are not exhaustive. They should not be relied upon as a substitute for the exercise of judgement, based on the principles set out in this code and any advice considered appropriate, particularly in light of any problems experienced in the past.

**a. How the control is to be implemented and the skills of the person performing the control**

For example, schemes should ensure that new employers participating in the scheme understand what member data are required and the process for supplying it. Where employers fail to supply the correct data or do not follow the correct process, schemes should ensure that the employer identifies the cause of the error and that appropriate action is taken to avoid recurrence, for example remedying a systemic error or providing the relevant training.

**b. The level of reliance that can be placed on information technology solutions where processes are automated**

For example, where scheme administration processes use an automated system, internal or external auditors could audit the system on an annual basis to assess whether it is capable of performing a required function and report any issues that are identified.

**c. Whether a control is capable of preventing future recurrence or merely detecting an event that has already happened**

For example, schemes should ensure that their systems support the maintenance and retention of good member records. This includes implementing procedures and controls which identify where systems are not fit for purpose, there are gaps in the data, the data are of a poor quality and/or there has been a loss of data.

**d. The frequency and timeliness of a control process**

For example, schemes should ensure that data are complete. They should undertake a data-cleansing or member-tracing exercise and review this on a regular basis (at least annually or at regular intervals that they consider appropriate for the scheme).

**e. How the control will ensure that data are managed securely**

For example, schemes should ensure that all staff, including temporary or contract staff, complete information management training before they are given access to sensitive data.

**f. The process for flagging errors or control failures, and approval and authorisation controls**

For example, schemes should ensure that member communications such as member information booklets are reviewed regularly, particularly where there are changes to the scheme. All relevant parties should be aware of how they should flag errors and the authorisation required before any changes are made to the communications.

**Monitoring controls effectively**

113. Risk assessment is a continual process and should take account of a changing environment and new and emerging risks, including significant changes in or affecting the scheme and employers who participate in the scheme.
114. For example, where relevant, schemes should put in place systems and processes for making an objective assessment of the strength of an employer's covenant (which should include analysis of their financial position, prospects and ability to pay the necessary employer contributions).
115. An effective risk assessment process will provide a mechanism to detect weaknesses at an early stage. Schemes should periodically review the adequacy of internal controls in:
  - mitigating risks
  - supporting longer-term strategic aims, for example relating to investments
  - identifying success (or otherwise) in achieving agreed objectives, and
  - providing a framework against which compliance with the scheme regulations and legislation can be monitored.
116. Internal or external audits and/or quality assurance processes should ensure that adequate internal controls are in place and being operated effectively. Reviews should take place when substantial changes take place, such as changes to pension scheme personnel, implementation of new administration systems or processes, or where a control has been found to be inadequate.
117. A persistent failure to put in place adequate internal controls may be a contributory cause of an administrative breach. Where the effect and wider implications of not having in place adequate internal controls are likely to be 'materially significant', the regulator would expect to receive a whistleblowing report that outlines relevant information relating to the breach. For more information, see the 'Reporting breaches of the law' section of this code.

118. Ultimately, the legal responsibility for establishing and operating adequate internal controls rests with the scheme manager<sup>54</sup>. Scheme regulations or other documents may delegate responsibilities to pension board members or others – for example identifying, evaluating and managing risks, developing and maintaining appropriate controls and providing assurance to the scheme manager about any controls in place. However, accountability for those controls and the governance of policies, procedures and processes will reside with the scheme manager.

## Outsourcing services

119. The legal requirements relating to internal controls apply equally where schemes outsource services connected with the running of the scheme. Providers should be required to demonstrate that they will have adequate internal controls in their tenders for delivering services. The requirements should be incorporated in the terms of engagement and contract between the scheme and service provider. Outsourced services may include, for example, the maintenance of records and data, calculation of benefits and investment management services. Where services are outsourced, scheme managers should be satisfied that internal controls associated with those services are adequate and effective.

120. An increasing number of service providers are obtaining independent assurance reports to help demonstrate their ability to deliver quality administration services. Schemes should ask their service providers to demonstrate that they have adequate internal controls relating to the services they provide. It is vital that schemes ensure they receive sufficient assurance from service providers. For example, the information from providers should be sufficiently detailed and comprehensive and the service level agreements should cover all services that are outsourced. Schemes should also consider including provisions in contracts for outsourced services requiring compliance with appropriate standards. This should help to ensure effective administration.

54  
Section 249B of the  
Pensions Act 2004.

# Administration

121. This part of the code covers:

- scheme record-keeping
- maintaining contributions, and
- providing information to members.

## Scheme record-keeping

### Legal requirements

122. Scheme managers must keep records of information relating to:

- member information<sup>55</sup>
- transactions<sup>56</sup>, and
- pension board meetings and decisions<sup>57</sup>.

123. The legal requirements are set out in the Public Service Pensions (Record Keeping and Miscellaneous Amendments) Regulations 2014 ('the Record Keeping Regulations').

### Practical guidance

124. Failure to maintain complete and accurate records and put in place effective internal controls to achieve this can affect the ability of schemes<sup>58</sup> to carry out basic functions. Poor record-keeping can result in schemes failing to pay benefits in accordance with scheme regulations, processing incorrect transactions and ultimately paying members incorrect benefits. For funded schemes, it may lead to schemes managing investment risks ineffectively. There is also the potential for the maladministration of members' contributions and failure to identify any misappropriation of assets. Schemes should be able to demonstrate to the regulator, where required, that they keep accurate, up-to-date and enduring records to be able to govern and administer their pension scheme efficiently.

125. Scheme managers must establish and operate adequate internal controls<sup>59</sup>, which should include processes and systems to support record-keeping requirements and ensure that they are effective at all times.

55  
Regulation 4 of the Record Keeping Regulations.

56  
Regulation 5, *ibid.*

57  
Regulation 6, *ibid.*

58  
See paragraph 25 for the definition of 'schemes'.

59  
Section 249B of the Pensions Act 2004.



## Records of member information

126. Scheme managers must ensure that member data across all membership categories specified in the Record Keeping Regulations is complete and accurate<sup>60</sup>. Member data should be subject to regular data evaluation.
127. Scheme managers must keep specific member data<sup>61</sup>, which will enable them to uniquely identify a scheme member and calculate benefits correctly. This is particularly important with the establishment of career average revalued earnings (CARE) schemes. Scheme managers must be able to provide members with accurate information regarding their pension benefits (accrued benefits to date and their future projected entitlements) in accordance with legislative requirements<sup>62</sup>, as well as pay the right benefits to the right person (including all beneficiaries) at the right time.
128. Schemes should require participating employers to provide them with timely and accurate data in order for the scheme manager to be able to fulfil their legal obligations. Schemes should seek to ensure that processes are established by employers which enable the transmission of complete and accurate data from the outset. Processes will vary from employer to employer, depending on factors such as employee turnover, pay periods, number of employees who are members and the timing and number of payroll processing systems.
129. Schemes should seek to ensure that employers understand the main events which require information about members to be passed from the employer to the scheme and/or another employer, such as when an employee:
- joins or leaves the scheme
  - changes their rate of contributions
  - changes their name, address or salary
  - changes their member status, and
  - transfers employment between scheme employers.
130. Schemes should ensure that appropriate procedures and timescales are in place for scheme employers to provide updated information when member data changes, for checking scheme data against employer data and for receiving information which may affect the profile of the scheme. If an employer fails to act according to the procedures set out above, meaning that they and/or scheme managers may not be complying with legal requirements, those under a statutory duty to report breaches of the law to the regulator under section 70 of the Pensions Act 2004 should assess whether there has been a relevant breach and take action as necessary.

<sup>60</sup>  
Section 16 and s30 of the 2013 Act. Regulation 4 of the Record Keeping Regulations specifies member records which must be kept. The Data Protection Act 1998 requires personal data to be accurate and up-to-date.

<sup>61</sup>  
Regulation 4 of the Record Keeping Regulations.

<sup>62</sup>  
Legislative requirements include s14 of the 2013 Act, HM Treasury directions made under that section, and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013.

## Records of transactions

131. Schemes should be able to trace the flow of funds into and out of the scheme and reconcile these against expected contributions and scheme costs. In doing so, they will have clear oversight of the core scheme transactions and should be able to mitigate risks swiftly.
132. Scheme managers must keep records of transactions made to and from the scheme and any amount due to the scheme which has been written off<sup>63</sup>. They should be able to demonstrate that they do so.

## Records of pension board meetings and decisions

133. Scheme managers must keep records of pension board meetings including any decisions made<sup>64</sup>. Schemes should also keep records of key discussions, which may include topics such as compliance with policies relating to administration of the scheme.
134. Scheme managers must also keep records relating to any decision taken by members of the pension board other than at a pension board meeting, or taken by a committee/sub-committee, which has not been ratified by the pension board. The records must include the date, time and place of the decision and the names of board members participating in that decision<sup>65</sup>. This will ensure that there is a clear and transparent audit trail of the decisions made in relation to the scheme.

## Retention of scheme records

135. Schemes should retain records for as long as they are needed. It is likely that data will need to be held for long periods of time and schemes will need to retain some records for a member even after that individual has retired, ensuring that pension benefits can be properly administered over the lifetime of the member and their beneficiaries. Schemes should have in place adequate systems and processes to enable the retention of records for the necessary time periods.

## Ongoing monitoring of data

136. Schemes should have policies and processes that monitor data on an ongoing basis to ensure it is accurate and complete, regardless of the volume of scheme transactions. This should be in relation to all membership categories, including pensioner member data where queries may arise once the pension is being paid.
137. Schemes should adopt a proportionate and risk-based approach to monitoring, based on any known or historical issues that may have occurred in relation to the scheme's administration. This is particularly important for the effective administration of CARE pension schemes, which requires schemes to hold significantly more data than needed for final salary schemes.

63  
Regulation 5 of the  
Record Keeping  
Regulations.

64  
Regulation 6, *ibid.*

65  
*Ibid.*

## Data review exercise

138. Schemes should continually review their data and carry out a data review exercise at least annually. This should include an assessment of the accuracy and completeness of the member information data held. Schemes should decide the frequency and nature of the review in light of factors such as the level of data quality, any issues identified and key scheme events.
139. Where the management of scheme data has been outsourced, it is vital that schemes understand and are satisfied that the controls in place will ensure the integrity of scheme member data. They should ensure that the administrator has assessed the risks that poor or deficient member records may present to the scheme and has taken the necessary steps to mitigate them, where applicable.
140. Where there has been a change of administrator or the administration system/platform, schemes should review and cleanse data records and satisfy themselves that all data are complete and accurate.

## Data improvement plan

141. Where schemes identify poor quality or missing data, they should put a data improvement plan in place to address these issues. The plan should have specific data improvement measures which schemes can monitor and a defined end date within a reasonable timeframe when the scheme will have complete and accurate data.

## Reconciliation of member records

142. Schemes should ensure that member records are reconciled with information held by the employer, for example postal address or electronic address (email address) changes and new starters. Schemes should also ensure that the numbers of scheme members is as expected based on the number of leavers and joiners since the last reconciliation. Schemes should be able to determine those members who are approaching retirement, those who are active members and those who are deferred members.

## Data protection and internal controls

143. Schemes must ensure that processes that are created to manage scheme member data meet the requirements of the Data Protection Act 1998 and the data protection principles.

144. Schemes should understand:

- their obligations as data controllers and who the data processors are in relation to the scheme
- the difference between personal data and sensitive personal data (as defined in the Data Protection Act 1998)
- how data are held and how they should respond to data requests from different parties
- the systems which need to be in place to store, move and destroy data, and
- how data protection affects member communications.

## Other legal requirements

145. In addition to the requirements set out in the Record Keeping Regulations, there are various other legal requirements that relate to record-keeping in public service pension schemes. Those requirements apply variously to managers, administrators and employers. Not all requirements apply to all public service pension schemes, but some of the key requirements are set out under the following legislation:

- Pensions Act 1995 and 2004
- Pensions Act 2008 and the Employers' Duties (Registration and Compliance) Regulations 2010<sup>66</sup>
- Occupational Pension Schemes (Scheme Administration) Regulations 1996
- Registered Pension Schemes (Provision of Information) Regulations 2006
- Data Protection Act 1998, and
- Freedom of Information Act 2000.

146. Where applicable, schemes should be able to demonstrate that they keep records in accordance with these and any other relevant legal requirements. Schemes should read the relevant legislation and any guidance in conjunction with this code where applicable.

<sup>66</sup> See the regulator's guidance about automatic enrolment for more information about record-keeping requirements under this legislation.

## Maintaining contributions

### Legal requirements

147. Employer contributions must be paid to the scheme in accordance with any requirements in the scheme regulations. Where employer contributions are not paid on or before the date they are due under the scheme and the scheme manager has reasonable cause to believe that the failure is likely to be of material significance to the regulator in the exercise of any of its functions, the scheme manager must give a written report of the matter to the regulator as soon as reasonably practicable<sup>67</sup>.
148. Where employee contributions are deducted from a member's pay, the amount deducted must be paid to the managers of the scheme at the latest by the 19th day of the month following the deduction, or by the 22nd day if paid electronically (the 'prescribed period')<sup>68</sup>, or earlier if required by scheme regulations. References to 'days' means all days. References to 'working days' do not include Saturdays, Sundays or Bank Holidays.
149. Where employee contributions are not paid within the prescribed period, if the scheme manager<sup>69</sup> has reasonable cause to believe that the failure is likely to be of material significance to the regulator in the exercise of any of its functions, they must give notice of the failure to the regulator and the member within a reasonable period after the end of the prescribed period<sup>70</sup>. Where there is a failure to pay employee contributions on an earlier date in accordance with scheme regulations, schemes should also consider their statutory duty under section 70 of the Pensions Act 2004 to assess and if necessary report breaches of the law. For more information about reporting breaches of the law, see this section of the code.

67  
Section 70A of the Pensions Act 2004.

68  
Section 49(8) of the Pensions Act 1995 and regulation 16 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

69  
The legal requirement to report late payments of employee contributions is imposed on the 'managers' of a scheme, which the regulator generally takes to be the 'scheme manager' identified in scheme regulations in accordance with the 2013 Act.

70  
Section 49(9) of the Pensions Act 1995.

71  
See paragraph 25 for the definition of 'schemes'.

### Practical guidance

150. As part of the requirement to establish and operate adequate internal controls, scheme managers should ensure that there are effective procedures and processes in place to identify payment failures that are – and are not – of material significance to the regulator. A 'payment failure' is where contribution payments are not paid to the scheme by the due date(s), or within the prescribed period and a 'materially significant payment failure' refers to a payment failure which is likely to be of material significance to the regulator in the exercise of its functions.
151. Schemes<sup>71</sup> should monitor pension contributions, resolve payment issues and report payment failures, as appropriate, so that the scheme is administered and managed in accordance with the scheme regulations and other legal requirements.

152. Adequate procedures and processes are likely to involve:

- developing a record to monitor the payment of contributions
- monitoring the payment of contributions
- managing overdue contributions, and
- reporting materially significant payment failures.

153. These procedures and processes should help scheme managers to meet their statutory duty to report materially significant payment failures to the regulator, as well as ensuring the effective management of scheme contributions and payment of the right pension.

### **Developing a record for monitoring the payment of contributions**

154. There are legislative requirements for managers of DB schemes to keep a schedule of contributions; and for DC schemes, a payment schedule, which allows managers to monitor contributions to their scheme. There are various exemptions from these requirements including for DB and DC schemes which are established by or under an enactment and which are guaranteed by a Minister of the Crown or other public authority, and for DB schemes which are pay-as-you-go schemes<sup>72</sup>.

155. Public service pension schemes which meet these exemptions should nonetheless develop a record for monitoring the payment of contributions to the scheme (a contributions monitoring record, which must reflect any requirements in scheme regulations where relevant). Schemes should prepare the contributions monitoring record in consultation with employers.

156. A contributions monitoring record will enable schemes to check whether contributions have been paid on time and in full, and, if they have not, provide a trigger for escalation for schemes to investigate the payment failure and consideration of whether scheme managers need to report to the regulator and, where relevant, members.

157. A contributions monitoring record should include the following information:

- contribution rates
- the date(s) on or before which employer contributions are to be paid to the scheme
- the date by when, or period within which, the employee contributions are to be paid to the scheme
- the rate or amount of interest payable where the payment of contributions is late.

72

Exemptions from the requirement to secure a schedule of contributions in respect of DB schemes under s227 of the Pensions Act 2004 are in regulation 17 of the Occupational Pension Schemes (Scheme Funding) Regulations 2005. Exemptions from the requirement to secure a payment schedule in respect of DC schemes under s87 of the Pensions Act 1995 is in regulation 17 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

158. The date when employer contributions must be paid is the date on or before which they are due under the scheme in accordance with the scheme regulations (or other scheme documentation). Schemes should assess the timing of payments against the date specified.
159. While there is a legal requirement for employee contributions to be paid to the scheme by the 19th day of the month following deduction, or by the 22nd day if paid electronically, this does not override any earlier time periods required by the scheme regulations. There are special rules for the first deduction of contributions on automatic enrolment under the Pensions Act 2008<sup>73</sup>.
160. A contributions monitoring record should help schemes to identify any employers who are not paying contributions on time and/or in full, support schemes to ensure that contributions are paid and employers to develop and implement new processes, as appropriate. The contributions monitoring record should provide schemes with information to maintain records of money received and will be useful for schemes to ensure that their member records are kept up-to-date.

### Monitoring the payment of contributions

161. Schemes should monitor contributions on an ongoing basis for all the membership categories within the scheme. Schemes should regularly check payments due against the contributions monitoring record.
162. Schemes should apply a risk-based and proportionate approach to help identify employers and situations which present a higher risk of payment failures occurring and which are likely to be of material significance and require the scheme manager to intervene.
163. Schemes should be aware of what is to be paid in accordance with the contributions monitoring record or other scheme documentation, which may be used by the pension scheme. Schemes should also have a process in place to identify where payments are late or have been underpaid, overpaid or not paid at all.
164. For schemes to effectively monitor contributions they will require access to certain information. Employers will often provide the payment information that schemes need to monitor contributions at the same time as they send the contributions to the scheme, which may be required under the scheme regulations. Payment information may include:
  - the employer and employee contributions due to be paid, which should be specified in the scheme regulations and/or other scheme documentation
  - the pensionable pay that contributions are based upon (where required), and
  - due date(s) on or before which payment of contributions and other amounts are to be made.

73  
Regulation 16 of the  
Occupational Pension  
Schemes (Scheme  
Administration)  
Regulations 1996.

165. Schemes should have adequate internal controls in place to monitor the sharing of payment information between the employer, pension scheme and member. Where the necessary payment information is not automatically available or provided by employers, schemes should request the additional information they need. Schemes may not need to obtain payment information as a matter of course, only where it is required for effective monitoring.
166. Scheme managers must record and retain information on transactions, including any employer and employee contributions received and payments of pensions and benefits<sup>74</sup>, which will support them in their administration and monitoring responsibilities.
167. Where the administration of scheme contributions is outsourced to a service provider, schemes should ensure that there is a process in place to obtain regular information on the payment of contributions to the scheme and a clear procedure in place to enable them to identify and resolve payment failures which may occur.

### Managing overdue contributions

168. When schemes identify or are notified of a problem, they should assess whether a payment failure has occurred before taking steps to resolve and, if necessary, report it. During their assessment, schemes should take into account:
- legitimate agreed payments made directly by an employer for scheme purposes, ie where the scheme has agreed that a contributions payment can be made late due to exceptional circumstances
  - legitimate agreed payment arrangements made between an employee and employer, ie where the employer has agreed that a contribution payment can be made late due to exceptional circumstances
  - contributions paid directly to a pension provider, scheme administrator or investment manager
  - any AVCs included with an employer's overall payment.
169. Where schemes identify a payment failure, they should follow a process to resolve issues quickly. This should normally involve the following steps:
- a. Investigate any apparent employer failure to pay contributions in accordance with the contributions monitoring record or legal requirements.
  - b. Contact the employer promptly to alert them to the payment failure and to seek to resolve the overdue payment.

74  
Regulation 5 of the  
Record Keeping  
Regulations.



- c. Discuss it further with the employer as soon as practicable to find out the cause and circumstances of the payment failure.
  - d. Ask the employer to resolve the payment failure and take steps to avoid a recurrence in the future.
170. Schemes should maintain a record of their investigation and communications between themselves and the employer. Recording this information will help to provide evidence of schemes' effective monitoring processes and could help to demonstrate that the scheme manager has met the legal requirement to establish and operate adequate internal controls. It will also form part of the decision of whether or not to report a payment failure to the regulator and, where relevant, members.
171. The regulator recognises that a monitoring process based on information provided by employers may not be able to confirm deliberate underpayment or non-payment, or fraudulent behaviour by an employer. Schemes should review current processes or develop a new process which is able to detect situations where fraud may be more likely to occur and where additional checks may be appropriate.
172. Ultimately, schemes have flexibility to design their own procedures so that they can obtain overdue payments and rectify administrative errors in the most effective and efficient way for their particular scheme.

### **Reporting payment failures which are likely to be of material significance to the regulator**

173. Scheme managers must report payment failures which are likely to be of material significance to the regulator within a reasonable period, in the case of employee contributions; and as soon as reasonably practicable in the case of employer contributions<sup>75</sup>.
174. Where schemes identify a payment failure, they should attempt to recover contributions within 90 days from the due date or prescribed period having passed without full payment of the contribution.
175. While schemes are not expected to undertake a full investigation to establish materiality or investigate whether an employer has behaved fraudulently, schemes should ask the employer:
- the cause and circumstances of the payment failure
  - what action the employer has taken as a result of the payment failure, and
  - the wider implications or impact of the payment failure.

75  
Section 49(9)(b) of the Pensions Act 1995 and s70A of the Pensions Act 2004.

176. When reaching a decision about whether to report, schemes should consider these points together and establish whether they have reasonable cause to report.
177. Having reasonable cause means more than merely having a suspicion that cannot be substantiated. Schemes should investigate the payment failure and use their judgement when deciding whether to report to the regulator.
178. Schemes may choose to take an employer's response to their enquiries at face value if they have no reason to believe it to be untrue or where their risk-based process indicates that there is a low risk of continuing payment failure. Where they receive no response, schemes may infer that an employer is unwilling to pay the contributions due.
179. Examples of payment failures that are likely to be of material significance to the regulator include:
- where schemes have reasonable cause to believe that the employer is neither willing nor able to pay contributions, for example in the event of a business failure or where an employer becomes insolvent and is unable to make pension payments
  - where there is a payment failure involving possible dishonesty or a misuse of assets or contributions, for example where schemes have concerns that an employer is retaining and using contributions to manage cash flow difficulties or where schemes have become aware that the employer has transferred contributions elsewhere other than to the pension scheme, which may be misappropriation
  - where the information available to schemes may indicate that the employer is knowingly concerned with fraudulently evading their obligation to pay employee contributions
  - where schemes become aware that the employer does not have adequate procedures or systems in place to ensure the correct and timely payment of contributions due and the employer does not appear to be taking adequate steps to remedy the situation, for example where there are repetitive and regular payment failures, or
  - any event where contributions have been outstanding for 90 days from the due date, unless the payment failure was a one-off or infrequent administrative error that had already been corrected on discovery or is thereafter corrected as soon as possible.

180. Examples of payment failures which are not likely to be of material significance to the regulator include:
- where a payment arrangement is being met by an employer for the recovery of outstanding contributions, or
  - where there are infrequent one-off payment failures or administrative errors such as where employees leave or join the scheme and those occasional failures or errors have been corrected within 90 days of the due date.
181. Schemes should identify and report to the regulator, as appropriate, any payment failures that may not be of material significance taken individually, but which could indicate a systemic problem. For example, an employer consistently failing to pay contributions by the due date or within the prescribed period, but paying within 90 days, may be due to inefficient scheme systems and processes. Schemes may also need to report payment failures that occur repeatedly and are likely to be materially significant to the regulator, depending on the circumstances.
182. Reporting payment failures of employer contributions as soon as ‘reasonably practicable’ means within a reasonable period from the scheme manager having reasonable cause to believe that the payment failure is likely to be of material significance to the regulator. Schemes should also consider whether it may be appropriate to report a payment failure of employer contributions to scheme members.
183. A reasonable period for reporting would be within ten working days from having reasonable cause to believe that the payment failure is likely to be of material significance. This will depend upon the seriousness of the payment failure and impact on the scheme. A written report should be preceded by a telephone call, if appropriate.
184. In the case of an employer failing to pay employee contributions to the pension scheme, if the scheme manager has reasonable cause to believe that the payment failure is likely to be of material significance to the regulator, the failure must be reported to the regulator<sup>76</sup> and members within a reasonable period after the end of the prescribed period<sup>77</sup>. A reasonable period for reporting to the regulator would be within ten working days and to members within 30 days of having reported to the regulator.
185. Reports relating to payment failures of employer contributions must be made in writing (preferably using our Exchange online service)<sup>78</sup>. In exceptional circumstances the scheme manager could make a telephone report.

76  
Reporting to the regulator does not affect any responsibility to report to another person or organisation.

77  
S49(8) and (9) of the Pensions Act 1995 and regulation 16 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996. Where there is a failure to pay employee contributions on an earlier date in accordance with scheme regulations, schemes should also consider their statutory duty under s70 of the Pensions Act 2004 to assess and if necessary report breaches of the law.

78  
Section 70A of the Pensions Act 2004.

186. The regulator has standardised reporting procedures and expectations regarding content, format and channel. For more information, see the section of this code on 'Reporting breaches of the law'.

## Providing information to members

### Legal requirements

187. The law requires schemes<sup>79</sup> to disclose information about benefits and scheme administration to scheme members and others. This section summarises the legal requirements relating to benefit statements and certain other information which must be provided and should be read alongside the requirements in the 2013 Act, HM Treasury directions<sup>80</sup> and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ('the Disclosure Regulations 2013'). In addition to these duties, there are other legal requirements relating to the provision of information to members and others under other legislation. See paragraph 211 for further details.

79  
See paragraph 25 for the definition of 'schemes'.

80  
Section 14 of the 2013 Act.

81  
Section 14(1) and s30(1) of the 2013 Act.

### Benefit statements

#### For active members of DB schemes under the 2013 Act

188. Scheme regulations must require scheme managers to provide an annual benefit information statement to each active member of a DB scheme established under the 2013 Act or new public body scheme<sup>81</sup>. The statement must include a description of the benefits earned by a member in respect of their pensionable service<sup>82</sup>.

82  
Section 14(2)(a), *ibid.*

83  
Section 14(4) and (5), *ibid.*

84  
Section 14(2)(b) and (6), *ibid.*

189. The first statement must be provided no later than 17 months after the scheme regulations establishing the scheme come into force. Subsequent statements must be provided at least annually after that date<sup>83</sup>.

85  
The Occupational Pension Schemes (Managers) Regulations 1986 specify who is to be treated as the 'manager' (in certain occupational public service pension schemes) for the purpose of providing information under specified legislation, including the Disclosure Regulations 2013, which may differ from the person who is the 'scheme manager'.

190. Statements must also comply with HM Treasury directions in terms of any other information which must be included and the manner in which they must be provided to members<sup>84</sup>.

#### For active, deferred or pension credit members of any DB public service pension scheme under the Disclosure Regulations 2013

191. Managers<sup>85</sup> of a scheme must also provide a benefit statement following a request by an active, deferred or pension credit member of a DB scheme if the information has not been provided to that member in the previous 12 months before that request<sup>86</sup>.

86  
Regulation 16 of the Disclosure Regulations 2013.

192. These benefit statements must include information about the amount of benefits by reference to a particular date and how they are calculated<sup>87</sup>. The full details depend on the type of member making the request.
193. The information must be given as soon as practicable but no more than two months after the date the request is made<sup>88</sup>.

### For members of a DC public service pension scheme under the Disclosure Regulations 2013

194. Managers of a scheme must provide a benefit statement to a member of a DC public service pension scheme, who is not an 'excluded person', within 12 months of the end of the scheme year<sup>89</sup>. An 'excluded person' is a member or beneficiary whose present postal address and email address is not known to the scheme because the correspondence has been returned (in the case of postal correspondence) or has not been delivered (in the case of electronic correspondence)<sup>90</sup>.
195. The information which must be provided includes the amount of contributions (before any deductions are made) credited to the member during the immediately preceding scheme year<sup>91</sup>, the value of the member's accrued rights under the scheme at a date specified by the managers of the scheme<sup>92</sup> and a statutory money purchase illustration<sup>93</sup>. The full detail of the information that must be provided is set out in the Disclosure Regulations 2013.

87  
Regulation 16 and Schedule 5 of the Disclosure Regulations 2013.

88  
Regulation 16(3), *ibid.*

89  
Regulation 17, *ibid.*

90  
Regulation 2, *ibid.*

91  
'Scheme year' is defined in Regulation 2, *ibid.*

92  
Regulation 17 and Schedule 6, *ibid.*

93  
Paragraph 6 and Schedule 6, *ibid.* There are certain exceptions to the requirements to provide this information.

94  
Regulation 4, *ibid.*

### Other information about scheme administration

196. Under the Disclosure Regulations 2013, managers of a scheme must provide other information to members and others in certain circumstances (for example, on request). The Regulations set out the information which must be given, the timescales for providing such information and the methods that may be used. Not all information must be provided in respect of all public service pension schemes (there are some exemptions for specified public service schemes or according to the type of benefit offered), but information which scheme managers may need to provide includes:
- basic scheme information
  - information about the scheme that has materially altered
  - information about the constitution of the scheme
  - annual report (this requirement will generally not apply to unfunded DB public service pension schemes and DB schemes for local government workers<sup>94</sup>)

- information about funding principles, actuarial valuations and payment schedules (these requirements will generally not apply to unfunded DB public service pension schemes and DB schemes for local government workers<sup>95</sup>)
- information about transfer credits
- information about lifestyling (this requirement will not apply in respect of DB benefits in public service pension schemes<sup>96</sup>)
- information about accessing benefits, and
- information about benefits in payment.

197. The detail of the information that must be provided to scheme members and others and any exemptions are set out in the Disclosure Regulations 2013. Managers must provide the required information, along with confirmation that members may request further information and the postal and email addresses to which a person should send those requests and enquiries<sup>97</sup>.

## Who is entitled to information

198. Managers of a scheme must ensure that scheme members and others are given information in accordance with the Disclosure Regulations 2013, unless they are an 'excluded person' (as defined above).

199. The Disclosure Regulations 2013 make provision for scheme members and others to receive information that is relevant to their pension rights and entitlements under the scheme. The categories of people who are entitled to receive information vary according to the different types of information, and there are exemptions where information has already been provided in a specified period. The detail of who is entitled to any particular type of information is set out in the Disclosure Regulations 2013 but may include any of the following ('a relevant person'):

- active members
- deferred members
- pensioner members
- prospective members
- spouses or civil partners of members or prospective members
- other beneficiaries, and
- recognised trade unions.

95  
Regulation 4 of the  
Disclosure Regulations  
2013.

96  
Regulation 18(1), *ibid.*

97  
Regulation 4(7), *ibid.*

## When basic scheme information must be provided

200. Managers must disclose certain basic information about the scheme and the benefits it provides to a prospective member (if practicable to do so) or a new member<sup>98</sup>. Where the manager has received jobholder information<sup>99</sup> for the member or prospective member they must provide the information within a month of the jobholder information being received<sup>100</sup>. Where they have not received jobholder information, they must provide the information within two months of the date the person became an active member of the scheme<sup>101</sup>.
201. Managers must also provide the information on request to a relevant person within two months of the request being made, except where the same information was provided to the same person or trade union in the 12 months before the request<sup>102</sup>.

## What information must be disclosed on request

202. In addition to the basic scheme information, pension scheme members and other relevant persons are entitled to request certain scheme information or scheme documents including:
- information about the constitution of the pension scheme, and
  - information about transfer credits<sup>103</sup>.

## How benefit statements and other information must be provided

203. Generally, schemes may choose how they provide information to scheme members, including by post, electronically (by email or by making it available on a website) or by any other means permitted by the law. For benefit statements issued under the 2013 Act, HM Treasury directions may specify how the information must be provided. Where schemes wish to provide information required under the Disclosure Regulations 2013 by electronic means there are important steps and safeguards that must first be met<sup>104</sup>. These include:
- scheme members and beneficiaries being provided with the option to opt out of receiving information electronically by giving written notice to the scheme
  - managers being satisfied that the electronic communications have been designed:
    - so that the person will be able to access and either store or print the relevant information and
    - taking into account the requirements of disabled people

98  
Regulation 6 of the Disclosure Regulations 2013.

99  
Specified in regulation 3 of the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010.

100  
Regulation 6(5) of the Disclosure Regulations 2013.

101  
Regulation 6(6), *ibid.*

102  
Regulation 6(4) and (7), *ibid.*

103  
Regulations 11, 14 and Parts 1 and 4 of Schedule 3, *ibid.*

104  
Regulation 26, *ibid.*

- ensuring that members and beneficiaries who were members or beneficiaries of the public service pension scheme on 1 December 2010 (where the scheme had not provided information electronically prior to that date) has been sent a written notice (other than via email or website), informing them that:
  - it is proposed to provide information electronically in the future and
  - scheme members and beneficiaries may opt out of receiving information electronically by sending written notice.

204. Where schemes make information or a document available on a website for the first time, they must give notice (other than via a website) to the recipient<sup>105</sup>. They must ensure that the notice includes:

- a statement advising that the information is available on the website
- the website address
- details of where on the website the information or document can be read, and
- an explanation of how the information or document may be read on the website<sup>106</sup>.

205. When any subsequent information is made available on a website, managers of a scheme must give a notice (other than via a website) to recipients informing them that the information is available on the website<sup>107</sup>. This notice will not be required where<sup>108</sup>:

- at least two documents have been given to the recipient by hand or sent to the recipient's last known postal address
- each of those letters asks the recipient to give their electronic (email) address to the scheme and informs the recipient of their right to request (in writing) that information or documents are not to be provided electronically
- a third letter has been given to the recipient by hand or sent to the recipient's last known postal address and includes a statement that further information will be available to read on the website and that no further notifications will be sent to the recipient and
- the managers of the scheme do not know the recipient's email address and have not received a written request that information or documents are not to be provided to the recipient electronically.

105  
Regulation 27(1) and (5) of the Disclosure Regulations 2013.

106  
Regulation 27(2), *ibid.*

107  
Regulation 27(3) and (5), *ibid.*

108  
Regulation 28, *ibid.*



206. In some cases, the Disclosure Regulations 2013 specify that information must be made available by one of the following methods<sup>109</sup>:

- available to view free of charge, at a place that is reasonable having regard to the request
- published on a website (in which case the procedure to be followed before making information available on a website does not apply, except that the person or trade union must be notified of certain details)
- given for a charge that does not exceed the expense incurred in preparing, posting and packing the information, or
- publicly available elsewhere.

## Practical guidance

207. Schemes should design and deliver communications to scheme members in a way that ensures they are able to engage with their pension provision. Information should be clear and simple to understand as well as being accurate and easily accessible. It is important that members are able to understand their pension arrangements and make informed decisions where required.

208. Schemes should attempt to make contact with their scheme members and, where contact is not possible, schemes should carry out a tracing exercise to locate the member and ensure that their member data are up-to-date.

209. Where a person has made a request for information, schemes should acknowledge receipt if they are unable to provide the information at that stage. Schemes may encounter situations where the time period for providing information takes longer than expected. In these circumstances, schemes should notify the person and let them know when they are likely to receive the information. Scheme managers and managers (where different) must provide information in accordance with the time periods specified in the 2013 Act and Disclosure Regulations 2013.

210. To promote transparency, schemes should make information readily available at all times to ensure that prospective and existing members are able to access information when they require it.

## Other legal requirements

211. Managers (or any other person specified in legislation) must comply with other legislation requiring information to be provided to members of public service pension schemes in certain circumstances. Not all requirements apply to all public service pension schemes and some may only arise in limited circumstances.

<sup>109</sup>  
Regulation 29 of the  
Disclosure Regulations  
2013.

Some of the requirements that schemes may need to be aware of are set out in or under the following legislation<sup>110</sup>:

- Occupational Pension Schemes (Contracting-out) Regulations 1996
- Occupational Pension Schemes (Transfer Values) Regulations 1996
- Occupational Pension Schemes (Winding up etc.) Regulations 2005
- Occupational Pension Schemes (Internal Dispute Resolution Procedures Consequential and Miscellaneous Amendments) Regulations 2008 (the requirements of these regulations are covered in the section of this code on 'Internal dispute resolution').

110

The legislation identified in this list is made under section 113 of the Pension Schemes Act 1993. There are other requirements that relate to providing information to members which arise under other legislation and which may be relevant to public service pension schemes (for example, under legislation relating to automatic enrolment and early leavers).

# Resolving issues

212. This part covers:

- internal dispute resolution, and
- reporting breaches of the law.

## Internal dispute resolution

### Legal requirements

213. Scheme managers<sup>111</sup> must make and implement dispute resolution arrangements that comply with the requirements of the law and help resolve pensions disputes between the scheme manager and a person with an interest in the scheme. 'Pension disputes'<sup>112</sup> cover matters relating to the scheme between the managers and one or more people with an interest in the scheme. These exclude 'exempted disputes'.

214. There are certain 'exempted disputes' to which the internal dispute resolution procedure will not apply<sup>113</sup>. This includes disputes where proceedings have commenced in any court or tribunal, or where the Pensions Ombudsman has commenced an investigation into it. Certain other prescribed disputes, for instance medical-related disputes that may arise in relation to police and fire and rescue workers, are also 'exempted disputes'<sup>114</sup>.

215. A person has an interest in the scheme if they:

- are a member or surviving non-dependant beneficiary of a deceased member of the scheme
- are a widow, widower, surviving civil partner or surviving dependant of a deceased member of the scheme
- are a prospective member of the scheme
- have ceased to be a member, beneficiary or prospective member or
- claim to be in one of the categories mentioned above and the dispute relates to whether they are such a person.

216. Dispute resolution arrangements may require people with an interest in the scheme to first refer matters in dispute to a 'specified person' in order for that person to consider and give their decision on those matters. The specified person's decision may then be confirmed or replaced by the decision taken by the scheme manager after reconsideration of the matters<sup>115</sup>.

111  
Legal requirements relating to the internal dispute resolution provisions are imposed on the 'managers' of a scheme, which the regulator generally takes to be the 'scheme manager' identified in scheme regulations in accordance with the 2013 Act.

112  
Section 50(3) of the Pensions Act 1995.

113  
Section 50(9), *ibid.*

114  
Regulation 4 of the Occupational Pension Schemes (Internal Dispute Resolution Procedures Consequential and Miscellaneous Amendments) Regulations 2008.

115  
Section 50(4A) of the Pensions Act 1995.

217. Scheme managers and specified persons (if used as part of a scheme's procedure) must take the decision required on the matters in dispute within a reasonable period of receiving the application. They must notify the applicant of the decision within a reasonable period of having taken it<sup>116</sup>.
218. Internal dispute resolution procedures must state the manner in which an application for the resolution of a pension dispute is to be made, the particulars which must be included in such an application and the manner in which any decisions required in relation to such an application are to be reached and given<sup>117</sup>. The procedure must specify a reasonable period within which applications must be made by certain people<sup>118</sup>.
219. Scheme managers must provide information about the scheme's dispute resolution procedure as well as information about The Pensions Advisory Service (TPAS) and the Pensions Ombudsman to certain people at certain stages<sup>119</sup>.

## Practical guidance

220. Scheme members expect their pension scheme to be managed effectively. Where a person with an interest in the scheme is not satisfied with any matter relating to the scheme (for example a decision which affects them), they have the right to ask for that matter to be reviewed.
221. Internal dispute resolution arrangements provide formal procedures and processes for pension scheme disputes to be investigated and decided upon quickly and effectively. They play a key role in the effective governance and administration of a scheme.
222. Schemes<sup>120</sup> can operate a two-stage procedure with a 'specified person' undertaking the first-stage decision. Alternatively, they may adopt a single-stage procedure if they consider that is more appropriate for their scheme.
223. With the exception of certain matters outlined below, the law does not prescribe the detail of the dispute resolution procedure. Schemes should decide on this and ensure it is fit for purpose.

116  
Section 50(5) of the Pensions Act 1995.

117  
Section 50B(4), *ibid.*

118  
Section 50B(3)(a), *ibid.*

119  
Regulation 6 of, and Part 1 of Schedule 2 to, the Disclosure Regulations 2013 and regulation 2 of the Occupational Pension Schemes (Internal Dispute Resolution Procedures) (Consequential and Miscellaneous Amendments) Regulations 2008.

120  
See paragraph 25 for the definition of 'schemes'.

## When applications should be submitted

224. Schemes may choose to specify time limits within which the following people must apply for a dispute to be resolved<sup>121</sup>:

- scheme members
- widows, widowers, surviving civil partners or surviving dependants of deceased scheme members
- surviving non-dependant beneficiaries of deceased scheme members, and
- prospective scheme members.

225. If schemes decide to specify time limits, they should publish and make those time limits readily available to ensure that those with an interest in the scheme are aware that they must submit an application within a prescribed time limit.

226. Scheme managers must ensure their scheme's procedure specifies a reasonable period within which applications by the following people must be made<sup>122</sup>:

- a person who has ceased to be within the categories in paragraph 224 above
- a person who claims that they were a person within the categories in paragraph 224 above and has ceased to be such a person, and the dispute relates to whether they are such a person.

227. A reasonable period would be six months beginning immediately after the date on which the person ceased to be, or claims they ceased to be, a person with an interest in the scheme. However, schemes have the flexibility to exercise their judgement and take an application outside a specified time period, if appropriate.

## When decisions should be taken

228. Managers and specified persons (where applicable) must decide the matter in dispute within a reasonable period of receiving the application. A reasonable period is within four months of receiving the application. In the case of a two-stage dispute resolution procedure, the reasonable period applies to each stage separately. Where a dispute is referred to scheme managers for a second-stage decision, the reasonable period begins when the managers receive the referral. However, there may be cases where it will be possible to process an application sooner than the reasonable time given. Where this is the case, there should not be a delay in taking the decision.

121  
Section 50B(3)(b) of the Pensions Act 1995.

122  
Section 50B(3)(a) of the Pensions Act 1995.

229. There may be exceptional circumstances of a particular dispute which may prevent the process being completed within the reasonable time period stated above. For instance, where the dispute involves unusually complex and labour-intensive calculations or research, or delays occur that are outside the control of the scheme manager (or specified person), or because they need to obtain independent evidence.
230. The regulator recognises that the circumstances of each dispute are different and decision times may vary. Schemes should be satisfied that the time taken to reach a decision is appropriate to the situation and be able to demonstrate this, if necessary.

### **When applicants should be informed of a decision**

231. Applicants must be notified of the decision made by a scheme manager and specified person (where applicable) within a reasonable time period after the decision has been made<sup>123</sup>. Schemes should usually notify applicants of the decision no later than 15 working days after the decision has been made. However, there may be cases where it is possible to notify an applicant sooner than the reasonable time given. Where this is the case, there should not be a delay in notifying them of the decision.
232. Schemes should provide the applicant with regular updates on the progress of their investigation. They should notify the applicant where the time period for a decision is expected to be shorter or longer than the reasonable time period and let them know when they are likely to receive an outcome.

### **Implementing the procedure and processes**

233. Scheme regulations or other documents recording policy about the administration of the scheme should specify internal dispute resolution arrangements. Schemes should focus on educating and raising awareness of their internal dispute resolution arrangements and ensuring that they are implemented.
234. Schemes should ensure that the effectiveness of the arrangements is assessed regularly and be satisfied that those following the process are complying with the requirements set, which includes effective decision making. This is particularly important where the arrangements require employers participating in the pension scheme to carry out duties as part of the process, for example where schemes have implemented the two-stage procedure and employers are acting as the specified person for the first stage.
235. Schemes should confirm and communicate their arrangements to members, for example, in the joining booklet. Schemes should make their arrangements accessible to potential applicants, for example by publishing them on a scheme website.

123  
Section 50(5) of the  
Pensions Act 1995.

236. Scheme managers must provide the following information about the procedure and processes the scheme has in place for the internal resolution of disputes to certain people in certain circumstances<sup>124</sup>:

- prospective members, if it is practicable to do so
- any scheme members who have not already been given the information
- certain relevant people who request the information and who have not been given that information in the previous 12 months, and
- members or prospective members when schemes receive jobholder information, or when a jobholder becomes an active member, in connection with automatic enrolment.

237. Scheme managers must also provide the postal or email address and job title of the person to contact in order to make use of the internal dispute arrangements.

238. In addition, scheme managers must provide information about TPAS and the Pensions Ombudsman at certain stages<sup>125</sup>. Upon receiving an application for the resolution of a pension dispute, scheme managers (or the specified person) must make the applicant aware as soon as reasonably practicable that TPAS is available to assist members and beneficiaries of the scheme and provide contact details for TPAS. When notifying the applicant of the decision, scheme managers must also inform the applicant that the Pensions Ombudsman is available to investigate and determine complaints or disputes of fact or law relating to a public service pension scheme and provide the Pension Ombudsman's contact details.

239. Schemes can decide what information they need from applicants to reach a decision on a disputed matter and how applications should be submitted. Schemes should ensure they make the following information available to applicants:

- the procedure and processes to apply for a dispute to be resolved
- the information that an applicant must include
- the process by which any decisions are reached, and
- an acknowledgement once an application has been received.

124  
Regulation 6 of, and Part 1 of Schedule 2 to, the Disclosure Regulations 2013.

125  
Regulation 2 of the Occupational Pension Schemes (Internal Dispute Resolution Procedures) (Consequential and Miscellaneous Amendments) Regulations 2008.

240. When reviewing an application, scheme managers and specified persons (where relevant) should ensure that they have all the appropriate information to make an informed decision. They should request further information if required. Scheme managers and specified persons should be satisfied that the times taken to reach a decision and notify the applicant are appropriate to the situation and that they have taken the necessary action to meet the reasonable time periods. Scheme managers should be able to demonstrate this to the regulator if required.

## Reporting breaches of the law

### Legal requirements

241. Certain people are required to report breaches of the law to the regulator where they have reasonable cause to believe that:

- a legal duty<sup>126</sup> which is relevant to the administration of the scheme has not been, or is not being, complied with
- the failure to comply is likely to be of material significance to the regulator in the exercise of any of its functions<sup>127</sup>.

For further information about reporting late payments of employee or employer contributions, see the section of this code on 'Maintaining contributions'.

242. People who are subject to the reporting requirement ('reporters') for public service pension schemes are:

- scheme managers<sup>128</sup>
- members of pension boards
- any person who is otherwise involved in the administration of a public service pension scheme
- employers<sup>129</sup>: in the case of a multi-employer scheme, any participating employer who becomes aware of a breach should consider their statutory duty to report, regardless of whether the breach relates to, or affects, members who are its employees or those of other employers
- professional advisers<sup>130</sup> including auditors, actuaries, legal advisers and fund managers: not all public service pension schemes are subject to the same legal requirements to appoint professional advisers, but nonetheless the regulator expects that all schemes will have professional advisers, either resulting from other legal requirements or simply as a matter of practice
- any person who is otherwise involved in advising the managers of the scheme in relation to the scheme<sup>131</sup>.

243. The report must be made in writing as soon as reasonably practicable<sup>132</sup>. See paragraph 263 for further information about how to report breaches.

126

The reference to a legal duty is to a duty imposed by, or by virtue of, an enactment or rule of law (s70(2)(a) of the Pensions Act 2004).

127

Section 70(2) of the Pensions Act 2004.

128

The legal requirement to report breaches of the law under section 70(1)(a) is imposed on the 'managers' of a scheme, which the regulator generally takes to be the 'scheme manager' identified in scheme regulations in accordance with the 2013 Act.

129

As defined in s318 of the Pensions Act 2004.

130

As defined in s47 of the Pensions Act 1995.

131

Section 70(1) of the Pensions Act 2004.

132

Section 70(2), *ibid.*



## Practical guidance

244. Schemes<sup>133</sup> should be satisfied that those responsible for reporting breaches are made aware of the legal requirements and this guidance. Schemes should provide training for scheme managers and pension board members. All others under the statutory duty to report should ensure they have a sufficient level of knowledge and understanding to fulfil that duty. This means having sufficient familiarity with the legal requirements and procedures and processes for reporting.

### Implementing adequate procedures

245. Identifying and assessing a breach of the law is important in reducing risk and providing an early warning of possible malpractice in public service pension schemes. Those people with a responsibility to report breaches, including scheme managers and pension board members, should establish and operate appropriate and effective procedures to ensure that they are able to meet their legal obligations. Procedures should enable people to raise concerns and facilitate the objective consideration of those matters. It is important that procedures allow reporters to decide within an appropriate timescale whether they must report a breach. Reporters should not rely on waiting for others to report.

246. Procedures should include the following features:

- a process for obtaining clarification of the law around the suspected breach where needed
- a process for clarifying the facts around the suspected breach where they are not known
- a process for consideration of the material significance of the breach by taking into account its cause, effect, the reaction to it, and its wider implications, including (where appropriate) dialogue with the scheme manager or pension board
- a clear process for referral to the appropriate level of seniority at which decisions can be made on whether to report to the regulator
- an established procedure for dealing with difficult cases
- a timeframe for the procedure to take place that is appropriate to the breach and allows the report to be made as soon as reasonably practicable
- a system to record breaches even if they are not reported to the regulator (the record of past breaches may be relevant in deciding whether to report future breaches, for example it may reveal a systemic issue), and
- a process for identifying promptly any breaches that are so serious they must always be reported.

133  
See paragraph 25  
for the definition of  
'schemes'.

## Judging whether a breach must be reported

247. Breaches can occur in relation to a wide variety of the tasks normally associated with the administrative function of a scheme such as keeping records, internal controls, calculating benefits and, for funded pension schemes, making investment or investment-related decisions.

### Judging whether there is 'reasonable cause'

248. Having 'reasonable cause' to believe that a breach has occurred means more than merely having a suspicion that cannot be substantiated.

249. Reporters should ensure that where a breach is suspected, they carry out checks to establish whether or not a breach has in fact occurred. For example, a member of a funded pension scheme may allege that there has been a misappropriation of scheme assets where they have seen in the annual accounts that the scheme's assets have fallen. However, the real reason for the apparent loss in value of scheme assets may be due to the behaviour of the stock market over the period. This would mean that there is not reasonable cause to believe that a breach has occurred.

250. Where the reporter does not know the facts or events around the suspected breach, it will usually be appropriate to check with the pension board or scheme manager or with others who are in a position to confirm what has happened. It would not be appropriate to check in cases of theft, suspected fraud or other serious offences where discussions might alert those implicated or impede the actions of the police or a regulatory authority. Under these circumstances the reporter should alert the regulator without delay.

251. If the reporter is unclear about the relevant legal provision, they should clarify their understanding of the law to the extent necessary to form a view.

252. In establishing whether there is reasonable cause to believe that a breach has occurred, it is not necessary for a reporter to gather all the evidence which the regulator may require before taking legal action. A delay in reporting may exacerbate or increase the risk of the breach.

### **Judging what is of 'material significance' to the regulator**

253. In deciding whether a breach is likely to be of 'material significance' to the regulator. It would be advisable for those with a statutory duty to report to consider the:

- cause of the breach
- effect of the breach
- reaction to the breach, and
- wider implications of the breach.

254. When deciding whether to report, those responsible should consider these points together. Reporters should take into account expert or professional advice, where appropriate, when deciding whether the breach is likely to be of material significance to the regulator.

### **Cause of the breach**

255. The breach is likely to be of material significance to the regulator where it was caused by:

- dishonesty
- poor governance or administration
- slow or inappropriate decision making practices
- incomplete or inaccurate advice, or
- acting (or failing to act) in deliberate contravention of the law.

256. When deciding whether a breach is of material significance, those responsible should consider other reported and unreported breaches of which they are aware. However, historical information should be considered with care, particularly if changes have been made to address previously identified problems.

257. A breach will not normally be materially significant if it has arisen from an isolated incident, for example resulting from teething problems with a new system or procedure, or from an unusual or unpredictable combination of circumstances. But in such a situation, it is also important to consider other aspects of the breach such as the effect it has had and to be aware that persistent isolated breaches could be indicative of wider scheme issues.

## Effect of the breach

258. Reporters need to consider the effects of any breach, but with the regulator's role in relation to public service pension schemes and its statutory objectives in mind, the following matters in particular should be considered likely to be of material significance to the regulator:

- pension board members not having the appropriate degree of knowledge and understanding, which may result in pension boards not fulfilling their roles, the scheme not being properly governed and administered and/or scheme managers breaching other legal requirements
- pension board members having a conflict of interest, which may result in them being prejudiced in the way that they carry out their role, ineffective governance and administration of the scheme and/or scheme managers breaching legal requirements
- adequate internal controls not being established and operated, which may lead to schemes not being run in accordance with their scheme regulations and other legal requirements, risks not being properly identified and managed and/or the right money not being paid to or by the scheme at the right time
- accurate information about benefits and scheme administration not being provided to scheme members and others, which may result in members not being able to effectively plan or make decisions about their retirement
- appropriate records not being maintained, which may result in member benefits being calculated incorrectly and/or not being paid to the right person at the right time
- pension board members misappropriating any assets of the scheme or being likely to do so, which may result in scheme assets not being safeguarded, and
- any other breach which may result in the scheme being poorly governed, managed or administered.

259. Reporters need to take care to consider the effects of the breach, including any other breaches occurring as a result of the initial breach and the effects of those resulting breaches.

## Reaction to the breach

260. Where prompt and effective action is taken to investigate and correct the breach and its causes and, where appropriate, notify any affected members, the regulator will not normally consider this to be materially significant.

261. A breach is likely to be of concern and material significance to the regulator where a breach has been identified and those involved:

- do not take prompt and effective action to remedy the breach and identify and tackle its cause in order to minimise risk of recurrence
- are not pursuing corrective action to a proper conclusion, or
- fail to notify affected scheme members where it would have been appropriate to do so.

### **Wider implications of the breach**

262. Reporters should consider the wider implications of a breach when they assess which breaches are likely to be materially significant to the regulator. For example, a breach is likely to be of material significance where the fact that the breach has occurred makes it appear more likely that other breaches will emerge in the future. This may be due to the scheme manager or pension board members having a lack of appropriate knowledge and understanding to fulfil their responsibilities or where other pension schemes may be affected. For instance, public service pension schemes administered by the same organisation may be detrimentally affected where a system failure has caused the breach to occur.

### **Submitting a report to the regulator**

263. Reports must be submitted in writing and can be sent by post or electronically, including by email or by fax. Wherever possible reporters should use the standard format available via the Exchange online service on the regulator's website.

264. The report should be dated and include as a minimum:

- full name of the scheme
- description of the breach or breaches
- any relevant dates
- name of the employer or scheme manager (where known)
- name, position and contact details of the reporter, and
- role of the reporter in relation to the scheme.

265. Additional information that would help the regulator includes:

- the reason the breach is thought to be of material significance to the regulator
- the address of the scheme
- the contact details of the scheme manager (if different to the scheme address)
- the pension scheme's registry number (if available), and
- whether the concern has been reported before.

266. Reporters should mark urgent reports as such and draw attention to matters they consider particularly serious. They can precede a written report with a telephone call, if appropriate.
267. Reporters should ensure they receive an acknowledgement for any report they send to the regulator. Only when they receive an acknowledgement can the reporter be confident that the regulator has received their report.
268. The regulator will acknowledge all reports within five working days of receipt, however it will not generally keep a reporter informed of the steps taken in response to a report of a breach as there are restrictions on the information it can disclose.
269. The reporter should provide further information or reports of further breaches if this may help the regulator to exercise its functions. The regulator may make contact to request further information.
270. Breaches should be reported as soon as reasonably practicable, which will depend on the circumstances. In particular, the time taken should reflect the seriousness of the suspected breach.
271. In cases of immediate risk to the scheme, for instance, where there is any indication of dishonesty, the regulator does not expect reporters to seek an explanation or to assess the effectiveness of proposed remedies. They should only make such immediate checks as are necessary. The more serious the potential breach and its consequences, the more urgently reporters should make these necessary checks. In cases of potential dishonesty the reporter should avoid, where possible, checks which might alert those implicated. In serious cases, reporters should use the quickest means possible to alert the regulator to the breach.

## Whistleblowing protection and confidentiality

272. The Pensions Act 2004 makes clear that the statutory duty to report overrides any other duties a reporter may have such as confidentiality and that any such duty is not breached by making a report. The regulator understands the potential impact of a report on relationships, for example, between an employee and their employer.
273. The statutory duty to report does not, however, override 'legal privilege'<sup>134</sup>. This means that oral and written communications between a professional legal adviser and their client, or a person representing that client, while obtaining legal advice, do not have to be disclosed. Where appropriate a legal adviser will be able to provide further information on this.

134  
Section 311 of the  
Pensions Act 2004.

274. The regulator will do its best to protect a reporter's identity (if desired) and will not disclose the information except where lawfully required to do so. It will take all reasonable steps to maintain confidentiality, but it cannot give any categorical assurances as the circumstances may mean that disclosure of the reporter's identity becomes unavoidable in law. This includes circumstances where the regulator is ordered by a court to disclose it.
275. The Employment Rights Act 1996 (ERA) provides protection for employees making a whistleblowing disclosure to the regulator. Consequently, where individuals employed by firms or another organisation having a statutory duty to report disagree with a decision not to report to the regulator, they may have protection under the ERA if they make an individual report in good faith. The regulator expects such individual reports to be rare and confined to the most serious cases.

# Appendix

## Corresponding Northern Ireland legislation

GB legislation	NI legislation
Pension Schemes Act 1993 (c. 48) - Chapter 1 of Part 4 - section 113	Pension Schemes (Northern Ireland) Act 1993 (c. 49) - Chapter 1 of Part 4 - section 109
Pensions Act 1995 (c. 26) - section 47 - section 49 - section 50 - section 50B - section 87	Pensions (Northern Ireland) Order 1995 (SI 1995/3213 (NI 22)) - Article 47 - Article 49 - Article 50 - Article 50B - Article 85
Employment Rights Act 1996 (c. 18)	Employment Rights (Northern Ireland) Order 1996 (SI 1996/1919 (NI 16))
Data Protection Act 1998 (c. 29)	Data Protection Act 1998 (c. 29)
Freedom of Information Act 2000 (c.36)	Freedom of Information Act 2000 (c.36)
Pensions Act 2004 (c. 35) - section 5 - section 13 - section 70 - section 70A - section 90A - Part 3 - section 227 - section 248 - section 248A - section 249A - section 249B - section 311 - section 318	Pensions (Northern Ireland) Order 2005 (SI 2005/255 (NI 1)) - Article 4 - Article 9 - Article 65 - Article 65A - Article 85A - Part 4 - Article 206 - Article 225 - Article 225A - Article 226A - Article 226B - Article 283 - Article 2
Pensions Act 2008 (c. 30)	Pensions (No. 2) Act (Northern Ireland) 2008 (c. 13)



GB legislation	NI legislation
Public Service Pensions Act 2013 (c. 25) <ul style="list-style-type: none"> <li>- section 1</li> <li>- section 2</li> <li>- section 3</li> <li>- section 4</li> <li>- section 5</li> <li>- section 6</li> <li>- section 7</li> <li>- section 14</li> <li>- section 15</li> <li>- section 16</li> <li>- section 28</li> <li>- section 30</li> <li>- Schedule 2</li> <li>- Schedule 3</li> </ul>	Public Service Pensions Act (Northern Ireland) 2014 (c. 2) <ul style="list-style-type: none"> <li>- section 1</li> <li>- section 2</li> <li>- section 3</li> <li>- section 4</li> <li>- section 5</li> <li>- section 6</li> <li>- section 7</li> <li>- section 14</li> <li>- section 15</li> <li>- section 16</li> <li>- section 28</li> <li>- section 31</li> <li>- Schedule 2</li> <li>- Schedule 3</li> </ul>
Occupational Pension Schemes (Managers) Regulations 1986 (SI 1986/1718)	Occupational Pension Schemes (Managers) Regulations (Northern Ireland) 1986 (SR 1986 No. 320)
Occupational Pension Schemes (Contracting-out) Regulations 1996 (SI 1996/1172)	Occupational Pension Schemes (Contracting-out) Regulations (Northern Ireland) 1996 (SR 1996 No. 493)
Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715)	Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1997 (SR 1997 No. 94)
Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847)	Occupational Pension Schemes (Transfer Values) Regulations (Northern Ireland) 1996 (SR 1996 No. 619)
Occupational Pension Schemes (Winding up etc.) Regulations 2005 (SI 2005/706)	Occupational Pension Schemes (Winding up, etc.) Regulations (Northern Ireland) 2005 (SR 2005 No. 171)
Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377)	Occupational Pension Schemes (Scheme Funding) Regulations (Northern Ireland) 2005 (SR 2005 No. 568)
Registered Pension Schemes (Provision of Information) Regulations 2006 (SI 2006/567)	Registered Pension Schemes (Provision of Information) Regulations 2006 (SI 2006/567)

GB legislation	NI legislation
Occupational Pension Schemes (Internal Dispute Resolution Procedures Consequential and Miscellaneous Amendments) Regulations 2008 (SI 2008/649)	Occupational Pension Schemes (Internal Dispute Resolution Procedures Consequential and Miscellaneous Amendments) Regulations (Northern Ireland) 2008 (SR 2008 No. 116)
Employers' Duties (Registration and Compliance) Regulations 2010 (SI 2010/5)	Employers' Duties (Registration and Compliance) Regulations (Northern Ireland) 2010 (SR 2010 No. 186)
Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 (SI 2010/772)	Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations (Northern Ireland) 2010 (SR 2010 No. 122)
Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734)	Occupational and Personal Pension Schemes (Disclosure of Information) Regulations (Northern Ireland) 2014 (SR 2014 No. 79)
Public Service Pensions (Record Keeping and Miscellaneous Amendments) Regulations 2014	Public Service Pensions (Record Keeping and Miscellaneous Amendments) Regulations (Northern Ireland) 2014

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Non-Executive Report of the:  <b>Pensions Committee</b>  9 <sup>th</sup> March 2016	
<b>Report of:</b> Zena Cooke, Corporate Director of Resources	<b>Classification:</b> Unrestricted
<b>Training and Development Policy and CIPFA Guidance For Members</b>	

<b>Originating Officer(s)</b>	Bola Tobun, Investment & Treasury Manager
<b>Wards affected</b>	All wards

### Summary

There are requirements for LGPS Pension Committee members, Pension Board members and officers to have an appropriate level of knowledge and skills. These are being driven by the Chartered Institute of Public Finance and Accountancy (CIPFA), the Pensions Regulator (TPR) and legislation and CIPFA has now published A Technical Knowledge and Skills Framework for local Pension Boards.

This report seeks the Pensions Committee to agree the updated Training and Development Policy which now includes the new CIPFA guidance for local Pension Boards, for the London Borough of Tower Hamlets Pension Fund, which will apply to all Pensions Committee, Pension Board and senior officers responsible for managing the Fund. Members of the Pensions Board are asked to attend the training sessions provided to Pensions Committee and also a wider programme of training.

### Recommendations:

The Pensions Committee is recommended to:

- i) Approve and adopt the updated Training and Development Policy for the London Borough of Tower Hamlets Pension Fund and
- ii) Note the need for each Pensions Committee Member, Pension Board Member and senior officer to adhere to the Training and Development Policy and maintain the required level of knowledge and skills.

## **1. REASONS FOR THE DECISIONS**

- 1.1 The responsibilities for the Pension Fund are complex and varied covering the whole spectrum of investments, administration and financial management. Training in all aspects of the Pension Fund and understanding the factors that will impact on the Fund mean that those charged with governance will be able to undertake effective decision making, including having an understanding of the financial impact of such decisions.
- 1.2 An approved transparent training and development policy will ensure those persons charged with governance and management of the Pension Fund understand what is expected of them as well as meeting with good practice. Any costs associated with delivering this Policy are immaterial in the context of the Pension Fund as many of the training sessions are provided free of charge or the costs are minimal. Any such costs are recharged to the Pension Fund.

## **2. ALTERNATIVE OPTIONS**

- 2.1 There are no alternatives.

## **3. DETAILS OF REPORT**

- 3.1 The Local Government Pension Scheme operates within a statutory and regulatory framework which includes the Superannuation Act 1972 and various statutory instruments including the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended). The department for Communities and Local Government (CLG) which is the government department responsible for the Local Government Pension scheme and CIPFA have also issued codes and guidance in respect of the scheme. The CLG Local Government Pension Scheme Governance Compliance Statements Statutory Guidance (2008) sets out nine principles for the governance of schemes including training.
- 3.2 In 2000 the government commissioned a review of investment management in the United Kingdom led by Paul Myners (now Lord Myners). Arising from Paul Myners' report the government issued a set of ten investment principles in 2001. In 2002 the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1988 were amended to require Local Government Pension Scheme Funds to report against these "Myners" principles.
- 3.3 In 2007 the government reviewed the "Myners" principles and in 2008 published a new set of six investment principles. These have now been reviewed and amplified in the context of the Local Government Pension Scheme by a group involving the department for Communities and Local Government, CIPFA and other stakeholders.
- 3.4 Principle 1 of the six revised "Myners" Principles is "Effective decision making" which states that in the context of the Local Government Pension Scheme it should be ensured that "decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively

and monitor their implementation”; and that “ those persons or organizations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

- 3.5 In recent years much greater focus has been placed on the need for administering authorities to embrace the requirement for a high level of knowledge and skills in the management of LGPS Funds and it has issued a Codes of Practice and Framework which can be adopted.
- 3.6 In accordance with the Public Service Pensions Act 2013 (PSPA) for each administering authority in the LGPS to introduce a Pension Board to assist the Scheme Manager, in this case the London Borough of Tower Hamlets Pensions Board members are legally required to have knowledge and understanding of pension scheme matters at a level that will allow them to properly exercise the functions of their role.
- 3.7 It remains possible that this legal requirement will be extended in future to cover LGPS Pension Fund Committee members. These requirements are also expanded on as part of The Pension Regulator's Public Sector Code of Practice along with the CIPFA Technical Knowledge and Skills Framework for local Pension Boards. The Training and Development Policy outlines how this level of knowledge will be achieved and maintained and has been updated since the original policy was agreed by the Pensions Board at its first meeting to reflect the additional CIPFA Guidance.

*London Borough of Tower Hamlets Pension Fund Training and Development Policy*

- 3.8 The updated Training and Development Policy details the training strategy for members of the Pensions Board, Pensions Committee and senior officers responsible for the management of the Fund. The updated Training and Development Policy has been created to provide a formal framework and greater transparency on the training regime in accordance with the national requirements. It will aid existing and future Pensions Committee Members, Pension Board Members and senior officers in their personal development and performance in their roles, providing a structure which will ensure that the Pension Fund is managed by individuals who have the appropriate levels of knowledge and skills. The updated training and development policy is set out in Appendix 1 of this report.
- 3.9 The Pensions Board are now being asked to formally adopt the updated Training and Development Policy of the London Borough of Tower Hamlets Pension Fund and to note the need for them individually and as a Board to undertake training in order to ensure that they are able to meet the requirements of being fully trained members of the Pensions Board.
- 3.10 As a reminder Pension Board Members can find more information about their role as Board Members on the Pensions Regulator's (TPR) website, please see link to relevant area: <http://www.thepensionsregulator.gov.uk/public-serviceschemes.aspx>. TPR states that: 'The law requires you to have knowledge and understanding of relevant pensions' law, and to have a working knowledge of your scheme regulations and documentation. Your responsibilities begin from the day you first take up your post, so you should start to familiarise yourself with the scheme documents and regulations as

soon as possible. Finding time to gain this knowledge may be a challenge, but you will need to do so in order to meet the legal requirement and carry out your role.' the Pensions Board are asked to log onto TPR's public sector toolkit <https://education.thepensionsregulator.gov.uk/login/index.php> and to avail themselves of this training module and to aim to complete over time all the areas covered by the toolkit and to keep records of the successful completion of the toolkit sections. Board Members are also asked to notify the Investment & Treasury Manager of completed modules to enable an up to date ongoing individual training record to be maintained, which will also be covered in an annual report of the Pensions Board to demonstrate compliance with the Regulations and TPR Code of Practice.

3.11 As noted earlier, CIPFA has now also issued the Technical Knowledge and Skills Framework for local Pension Boards and this is attached as Appendix 2 to this report. This sets out the purpose, scope and status of the guidance along with the policy and legislative background. Referencing Key Skills required is broken down in to the following sections:

- i) Pensions Legislation
- ii) Public Sector Pensions Governance
- iii) Pensions Administration
- iv) Pensions Accounting and Auditing Standards
- v) Pensions Services Procurement and Relationship Management
- vi) Investment Performance and Risk Management
- vii) Financial Markets and Product Knowledge
- viii) Actuarial Methods, Standards and Practices

3.12 Pension Board Members, Pensions Committee Members and senior officers will continue to be provided with ongoing opportunities to attend training events to assist them in adhering to the policy.

#### **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

4.1 The comments of the Corporate Director, Resources are incorporated in the report

#### **5. LEGAL COMMENTS**

5.1 Members of the Pensions Board are required by the Local Government Pension Scheme (Amendment) (Governance) Regulations 2014 to have the relevant experience and capacity to represent members of the Scheme. It is essential that members are trained appropriately so that decisions are made from a sound knowledge base thereby minimising the risk of any legal challenge. The Training and Development Policy should provide Members with the required level of knowledge and skills to carry out their functions of assisting the Administering Authority in the proper governance and administration of the Pension Fund and to ensure compliance with the relevant regulations and legislation.



- 5.2 When exercising their functions, Pension Board Members must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who do not (the public sector equality duty)

## **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for corporate priorities.
- 6.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

## **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 This report helps in addressing the required knowledge and skills needed for Members to understand the duties and responsibilities of a trustee and how best to fulfil these effectively, efficiently and in accordance with regulatory requirements.

## **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 Any form of decision making process inevitably involves a degree of risk.
- 9.2 Effective training and development will help Members to gain sufficient knowledge and skills necessary to make appropriate decisions in minimising risk associated with their roles and responsibilities.

## **10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 10.1 There are no crime and disorder reduction implications arising from this report.

---

### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

- [None]

#### **Appendices**

- Appendix 1 – LBTH Training & Development Policy
- Appendix 2 - CIPFA Knowledge and Skills Framework for Local Pension Board members 2015

#### **Local Government Act, 1972 Section 100D (As amended)**

#### **List of "Background Papers" used in the preparation of this report**

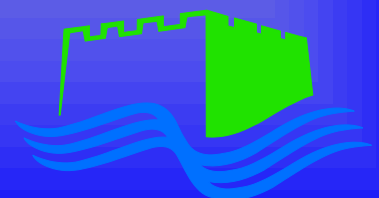
Pensions Finance, knowledge and skills framework, Technical Guidance for Elected Representatives and Non-executives in the Public Sector, CIPFA (2010)

Investment decision making and disclosure in the Local Government Pension Scheme, A Guide to the Application of the Myners Principles, CIPFA (2009)

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- Bola Tobun Investment & Treasury Manager x4733

# The London Borough of Tower Hamlets Pension Fund Training & Development Policy



## **Introduction**

This is the Training & Development Policy of the London Borough of Tower Hamlets Pension Fund in relation to the Local Government Pension Scheme (LGPS), which is managed and administered by Tower Hamlets Council. The Policy details the training strategy for members of the Pensions Committee and Pension Board, and senior officers responsible for the management of the Fund.

This Training & Development Policy is established to assist Pensions Committee and Pensions Board members and senior officers in developing their knowledge and capabilities in their individual roles, with the ultimate aim of ensuring that the London Borough of Tower Hamlets Pension Fund is managed by individuals who have the appropriate levels of knowledge and skills.

Tower Hamlets Council has delegated responsibility for the implementation of this Training & Development Policy to the Corporate Director, Resources.

## **Aims and Objectives**

Tower Hamlets Council recognises the significance of its role as Administering Authority to the London Borough of Tower Hamlets Pension Fund on behalf of its stakeholders which include:

- around 19,000 current and former members of the Fund, and their dependants
- about 20 employers within the Tower Hamlets Council area or with close links to Tower Hamlets Council
- the local taxpayers within the London Borough of Tower Hamlets.

In relation to the governance of the Fund, the objectives are to ensure that:

- all staff and Pensions Committee Members charged with the financial administration and decision-making with regard to the Fund are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them
- the Fund is aware that good governance means an organisation is open in its dealings and readily provides information to interested parties
- all relevant legislation is understood and complied with
- the Fund aims to be at the forefront of best practice for LGPS funds
- the Fund manages Conflicts of Interest appropriately

This Policy has been put in place to assist the Fund in achieving these objectives and all Pensions Committee Members, Pension Board members and senior officers to whom this Policy applies are expected to continually demonstrate their own personal commitment to training and to ensuring that these objectives are met.

To assist in achieving these objectives, the London Borough of Tower Hamlets Pension Fund will aim to comply with:

- the CIPFA Knowledge and Skills Frameworks and
- the knowledge and skills elements of the Public Service Pensions Act 2013 and The Pensions Regulator's (TPR) Code of Practice for Public Service Schemes

As well as any other LGPS specific guidance relating to the knowledge and skills of Pensions Committee members, Pension Board members or pension fund officers which may be issued from time to time.

This Training & Development Policy applies to all Members of the Pensions Committee, Pensions Board, including scheme member and employer representatives. It also applies to all managers in the Tower Hamlets Council Pension Fund Management Team and the Chief Finance Officer (Section 151 Officer) (from here on in collectively referred to as the senior officers of the Fund).

Other officers involved in the daily management of the Pension Fund will also be required to have appropriate knowledge and skills relating to their roles, which will be determined and managed by the Pension Fund Manager and Investment & Treasury Manager and his/her team.

The advisers to the Fund that provides the day to day and strategic advice to the London Borough of Tower Hamlets Pension Fund are also expected to be able to meet the objectives of this Policy, as are all other officers of employers participating in the London Borough of Tower Hamlets Pension Fund who are responsible for pension matters are also encouraged to maintain a high level of knowledge and understanding in relation to LGPS matters, and Tower Hamlets Council will provide appropriate training for them.

This is considered separately in the London Borough of Tower Hamlets Pension Fund Administration Strategy.

### **CIPFA and TPR Knowledge and Skills Requirements - *(CIPFA Knowledge and Skills Framework and Code of Practice)***

In January 2010 CIPFA launched technical guidance for Representatives on Pensions Committees and non-executives in the public sector within a knowledge and skills framework. The Framework details the knowledge and skills required by those responsible for pension scheme financial management and decision making.

In July 2015 CIPFA launched technical guidance for Local Pension Board members by extending the existing knowledge and skills frameworks in place. This Framework details the knowledge and skills required by Pension Board members to enable them to properly exercise their functions under Section 248a of the Pensions Act 2004, as amended by the Public Service Pensions Act 2013.

The Framework covers eight areas of knowledge and skills identified as the core requirements (which include all those covered in the existing Committee and nonexecutives' framework):

- i) Pensions legislation
- ii) Public sector pensions governance
- iii) Pension accounting and auditing standards
- iv) Pensions administration
- v) Financial services procurement and relationship management
- vi) Investment performance and risk management
- vii) Financial markets and products knowledge
- viii) Actuarial methods, standards and practice

CIPFA's Code of Practice recommends (amongst other things) that Local Government Pension Scheme administering authorities -

- formally adopt the CIPFA Knowledge and Skills Frameworks (or an alternative training programme)
- ensure that the appropriate policies and procedures are put in place to meet the requirements of the Frameworks (or an alternative training programme);
- publicly report how these arrangements have been put into practice each year.

#### **The Pensions Act 2004 and the Pension Regulator's Code of Practice**

Section 248a of the Pensions Act 2004, as amended by The Public Service Pensions Act 2013 (PSPA13) requires Pension Board members to:

- be conversant with the rules of the scheme and any document recording policy about the administration of the scheme, and
- have knowledge and understanding of the law relating to pensions and any other matters which are prescribed in regulations.

The degree of knowledge and understanding required is that appropriate for the purposes of enabling the individual to properly exercise the functions of a member of the Pension Board.

These requirements are incorporated and expanded on within the TPR Code of Practice which came into force on 1 April 2015. It is expected that guidance will also be issued by the Local Government Pension Scheme Advisory Board which will explain further how these requirements will relate to LGPS administering authorities.

#### **Application to the London Borough of Tower Hamlets Pension Fund**

Tower Hamlets Council recognises that effective financial administration, scheme governance and decision-making can only be achieved where those involved have the requisite knowledge and skills. Accordingly it fully supports the use of the CIPFA Knowledge and Skills Frameworks, and TPR's Code of Practice. Tower Hamlets Council adopts the principles contained in these publications in relation to the London Borough of Tower Hamlets Pension Fund, and this Training and Development Policy highlights how the Council will strive to achieve those principles through use of a Training Plan together with regular monitoring and reporting.

#### **The London Borough of Tower Hamlets Pension Fund Training and Development Plan**

Tower Hamlets Council recognises that attaining, and then maintaining, relevant knowledge and skills is a continual process for Pensions Committee members, Pension Board members and senior officers, and that training is a key element of this process. Tower Hamlets Council will develop a rolling Training Plan based on the following key elements:

- 1) **Individual Training Needs:** A training needs analysis will be developed for the main roles of Pensions Committee members, Pension Board members and senior officers customised appropriately to the key areas in which they should be proficient. Training will be required in relation to each of these areas as part of any induction and on an ongoing refresher basis.

- 2) **Hot Topic Training:** The Training Plan will be developed to ensure appropriately timed training is provided in relation to hot topic areas, such as a high risk area or a specific area where decisions need to be made. This training may be targeted at specific roles.
- 3) **General Awareness:** Pensions Committee members, Pension Board members and senior officers are expected to maintain a reasonable knowledge of ongoing developments and current issues, which will allow them to have a good level of general awareness of pension related matters appropriate for their roles and which may not be specific to the London Borough of Tower Hamlets Pension Fund.

Each of these training requirements will be focussed on the role of the individual i.e. a Pensions Committee member, a Pension Board member or the specific role of the officer.

The Pensions Committee agrees a training plan on an annual basis at the first meeting of the Municipal Year. The training plan is developed taking into consideration the needs of the Committee, the Board and officers to both enhance existing knowledge and skills and to develop new areas of understanding. This ensures that training is accessible to all Committee and Board members and key officers involved in the management of the Pension Fund.

Training will be delivered through a variety of methods including:

- In-house training days provided by officers and/or external providers
- Training as part of meetings (e.g. Pensions Committee) provided by officers and/or external advisers
- External training events
- Circulation of reading material
- Attendance at seminars and conferences offered by industry-wide bodies
- Attendance at meetings and events with the London Borough of Tower Hamlets Pension Fund's investment managers and advisors
- Links to on-line training
- Access to the London Borough of Tower Hamlets Pension Fund website where useful London Borough of Tower Hamlets Pension Fund specific material is available.

In addition London Borough of Tower Hamlets Pension Fund officers and advisers are available to answer any queries on an ongoing basis including providing access to materials from previous training events.

### **Initial Information and Induction Process**

On joining the Pensions Committee, the Pension Board or the London Borough of Tower Hamlets Pension Fund Management Team, a new member or officer will be provided with the following documentation to assist in providing them with a basic understanding of London Borough of Tower Hamlets Pension Fund:

- The members' guide to the Local Government Pension Scheme (LGPS)
- The latest Actuarial Valuation report
- The Annual Report and Accounts, which incorporate:
  - The Funding Strategy Statement

- The Governance Policy and Compliance Statement
- The Statement of Investment Principles including the London Borough of Tower Hamlets Pension Fund's statement of compliance with the LGPS Myners Principles
- The Communications Policy
- The Administration Strategy
- The administering authority's Discretionary Policies
- The Training Policy

In addition, an individual training plan will be developed to assist each Pensions Committee member, Pension Board member or officer to achieve, within six months, their identified individual training requirements.

### **Monitoring Knowledge and Skills**

To identify if Pensions Committee members, Pension Board members and senior officers are meeting the objectives of this policy we will:

- 1) Compare and report on attendance at training based on the following:
  - i. Individual Training Needs – ensuring refresher training on the key elements takes place for each individual at least once every three years.
  - ii. Hot Topic Training – attendance by at least 80% of the required Pensions Committee members, Pension Board members and senior officers at planned hot topic training sessions. This target may be focussed at a particular group of Pensions Committee members, Pension Board members or senior officers depending on the subject matter.
  - iii. General Awareness – each Pensions Committee member, Pension Board member or officer attending at least one day each year of general awareness training or events.
  - iv. Induction training – ensuring areas of identified individual training are completed within six months.
  
- 2) Consider whether the objectives have been met as part of the annual self-assessment carried out each year which is completed by all Pensions Committee members, Pension Board members and senior officers.

The key risks to the delivery of this Policy are outlined below:

- i. Changes in Pensions Committee and/or Pension Board membership and/or senior officers' potentially diminishing knowledge and understanding.
- ii. Poor attendance and/or a lack of engagement at training and/or formal meetings by Pensions Committee Members, Pension Board Members and/or other senior officers resulting in a poor standard of decision making and/or monitoring.
- iii. Insufficient resources being available to deliver or arrange the required training.
- iv. The quality of advice or training provided not being to an acceptable standard.

The Pensions Committee members, with the assistance of London Borough of Tower Hamlets senior officers and Pension Board members will monitor these and other key risks and consider how to respond to them.



## **Reporting**

A report will be presented to the Pensions Committee on an annual basis setting out:

- i. The training provided / attended in the previous year at an individual level
- ii. Attendance at Pensions Committee and Pension Board meetings
- iii. The results of the measurements identified above.

This information will also be included in the London Borough of Tower Hamlets Pension Fund's Annual Report and Accounts.

At each Pensions Committee and Pensions Board meeting, members will be provided with details of forthcoming seminars, conferences and other relevant training events as well as a summary of the events attended since the previous meeting.

## **Costs**

All training costs related to this Training and Development Policy are met directly by the London Borough of Tower Hamlets Pension Fund.

## **Approval, Review and Consultation**

This Training and Development Policy was originally approved at the London Borough of Tower Hamlets Pensions Committee meeting of September 2015 and amendments to incorporate the requirements of the CIPFA Local Pension Boards Framework would be approved on 9<sup>th</sup> March 2016. This Training and Development Policy was also adopted by the London Borough of Tower Hamlets Pension Board at its first meeting. It will be formally reviewed and updated at least every year or sooner if the training arrangements or other matters included within it worth re-evaluation.

### **Further Information**

If you require further information about anything in or related to this Training and Development Policy, please contact:

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# local pension boards

A Technical Knowledge and Skills  
Framework



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# local pension boards

A Technical Knowledge and Skills  
Framework

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# Acknowledgements

This framework has been developed by Nigel Keogh (CIPFA Pensions Technical Manager) with guidance, direction and support from the CIPFA Pensions Panel.

The current members of the Pensions Panel are:

Bob Summers (Chairman) – Independent Consultant

Paul Dale – London Borough of Merton

Geoff Dobson – Suffolk County Council

Geik Drever – West Midlands Pension Fund

Jeff Houston – Local Government Employers Pensions Committee

John Hattersley – South Yorkshire Pensions Authority

Nicola Mark – Norfolk Pension Fund

Susan Martin – London Pensions Fund Authority

Paul Mayers – National Audit Office

Richard McIndoe – Glasgow Council

Chris Megainey – Department for Communities and Local Government

Graeme Russell (Vice Chairman) – Torfaen Borough Council

Trevor Salmon – Northern Ireland Local Government Officers' Superannuation Committee

Mark Taylor – Audit Scotland

Chris West – Coventry City Council

John Wright – Hymans Robertson

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# 1. Purpose, Scope and Status of this Guidance

## PURPOSE

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- 1.1 A great deal of work has been done in recent years to address the provision of training to those who are involved in the administration of public service pension schemes. However in the absence of any detailed definition of what knowledge and skills are actually required to carry out a particular role, it is difficult to ascertain whether training is truly effective.
- 1.2 In an attempt to ensure that training can be delivered efficiently and effectively by identifying and focusing on the key knowledge areas, in recent years CIPFA has developed, with the assistance of expert practitioners, frameworks covering the knowledge and skills requirements for officers and elected members/non-executives involved in the administration of public service pension schemes.
- 1.3 The proposals in this publication are intended to further promote good governance in public service pension schemes' pension boards by extending these frameworks to cover the training and development of their board members. The objective is to improve knowledge and skills in all the relevant areas of activity of a pension board and assist board members in achieving the degree of knowledge appropriate for the purposes of enabling the individual to properly exercise the functions of a member of the pension board as required under Section 248a of the *Pensions Act 2004*<sup>1</sup>, as amended by the *Public Service Pensions Act 2013*.

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1. Section 248a of the *Pensions Act 2004* sets out the following:

***Requirement for knowledge and understanding: pension boards of public service pension schemes***

- (1) *This section applies to every individual who is a member of the pension board of a public service pension scheme.*
- (2) *An individual to whom this section applies must be conversant with—*
  - (a) *the rules of the scheme, and*
  - (b) *any document recording policy about the administration of the scheme which is for the time being adopted in relation to the scheme.*
- (3) *An individual to whom this section applies must have knowledge and understanding of—*
  - (a) *the law relating to pensions, and*
  - (b) *such other matters as may be prescribed.*
- (4) *The degree of knowledge and understanding required by subsection (3) is that appropriate for the purposes of enabling the individual properly to exercise the functions of a member of the pension board.*

- 1.4 This guidance is intended to complement the Pensions Regulator's *Code of Practice No 14: Governance and Administration of Public Service Pension Schemes* (2015)<sup>2</sup>. The *Code of Practice No 14* sets out the fact that the law requires, amongst other things, that local pension board members be conversant with the rules of the scheme and documents relating to its administration. Additionally, in the context of the Local Government Pension Scheme (LGPS) in particular, this will bring board members into contact with matters relating to investments, actuarial valuations, third party provision, scheme assurance, accounting and auditing<sup>3</sup>. This guidance therefore focusses on those areas by expanding on the specifics of the knowledge and skills requirements associated with public service pension schemes in general and the LGPS in particular, and assisting both scheme managers and pension board members in discharging their responsibilities as set out in the Pensions Regulator's *Code of Practice No 14* insofar as they apply to knowledge and skills (a summary of the respective responsibilities of board members and the scheme manager can be found at Annex A).

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## SCOPE

- 1.5 The guidance is set in the context of LGPS pension boards in England and Wales but pension boards in other sectors and jurisdictions may find the frameworks of use in determining their own training programmes for pension board members.

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2. [www.thepensionsregulator.gov.uk/docs/code-14-public-service.pdf](http://www.thepensionsregulator.gov.uk/docs/code-14-public-service.pdf)

3. The Pensions Regulator's *Code of Practice 14: Governance and Administration of Public Service Pension Schemes* states in paragraphs 42 to 44:

*'For pension board members of funded pension schemes, documents which record policy about the administration of the scheme will include those relating to funding and investment matters. For example, where relevant they must be conversant with the statement of investment principles and the funding strategy statement.*

*Pension board members must also be conversant with any other documented policies relating to the administration of the scheme. For example, where applicable, they must be conversant with policies relating to:*

- *the contribution rate or amount (or the range/variability where there is no one single rate or amount) payable by employers participating in the scheme*
- *statements of assurance (for example, assurance reports from administrators)*
- *third party contracts and service level agreements*
- *stewardship reports from outsourced service providers (for example, those performing outsourced activities such as scheme administration), including about compliance issues*
- *scheme annual reports and accounts*
- *accounting requirements relevant to the scheme*
- *audit reports, including from outsourced service providers, and*
- *other scheme-specific governance documents.'*

- 1.6 The framework is intended to have two primary uses:
- as a tool for scheme managers in meeting the Pensions Regulator’s *Code of Practice No 14* which states that scheme managers should ‘*establish and maintain policies and arrangements for acquiring and retaining knowledge and understanding to support their pension board members*’
  - as an assessment tool for individuals to measure their progress and plan their development in order to ensure that they have the appropriate degree of knowledge and understanding to enable them to properly exercise their functions as a member of a pension board.
- 1.7 The framework is intended to apply to all pension board members. However, it has been designed so that organisations and individuals can tailor it to their own particular circumstances.
- 1.8 In addition, in recognition of the more onerous roles of chairs, the framework also includes a specimen role specification for the chair of a pension board (see the example at Annex B).

## STATUS

- 1.9 In 2013, CIPFA issued a *Code of Practice on Public Sector Pensions Finance Knowledge and Skills*.
- 1.10 The *Code of Practice on Public Sector Pensions Finance Knowledge and Skills* is underpinned by five key principles:
1. Organisations responsible for the financial administration of public sector pension schemes recognise that effective financial management, decision-making, governance and other aspects of the financial administration of public sector pension schemes can only be achieved where those involved have the requisite knowledge and skills.
  2. Organisations have the necessary resources in place to acquire and retain the necessary public sector pension scheme finance knowledge and skills.
  3. Organisations have in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective acquisition and retention of public sector pension scheme finance knowledge and skills for those in the organisation responsible for financial administration, scheme governance and decision-making.
  4. The associated policies and practices are guided by reference to a comprehensive framework of knowledge and skills requirements such as that set down in the *CIPFA Pensions Finance Knowledge and Skills Frameworks*.
  5. The organisation has designated a named individual<sup>4</sup> to be responsible for ensuring that policies are implemented.
- 1.11 In setting out the *Code of Practice on Public Sector Pensions Finance Knowledge and Skills*, the Institute stated that ‘*this Code of Practice applies to all individuals that take on a*

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4. The officer in question should be the senior officer responsible for the financial administration of the pension scheme. In the case of the LGPS, this would usually be the chief financial officer; in the NHS, for example, it would be the accounting officer.

*decision-making, scrutiny or oversight role. This includes (where relevant to the governance structures employed in the management of the LGPS):*

- *officers of the administering authority*
- *elected members of the administering authority*
- *employer representatives*
- *member-nominated representatives*
- *pensioner representatives*
- *co-opted members*
- *independent advisors*
- *internal auditors and audit committee members*
- *any other individuals involved in a decision-making, scrutiny or oversight role.*

*The requirements will also apply to the members of local pension boards as set out in section 5 of the Public Service Pensions Bill, as and when such boards are established.'*

- 1.12** It is therefore the professional responsibility of the named individual referred to under principle 5 above to establish and maintain policies and arrangements for acquiring and retaining knowledge and skills to support their pension board members. This professional requirement is in line with the Pensions Regulator's *Code of Practice No 14* as set out in paragraph 38 of that Code<sup>5</sup>.
- 1.13** This guidance is offered as good practice in line with the previous *CIPFA Pensions Finance Knowledge and Skills Frameworks*, and is intended to assist practitioners in meeting their responsibilities under CIPFA's *Code of Practice on Public Sector Pensions Finance Knowledge and Skills* (2013), particularly principle 4.

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5. Paragraph 38 of the Pensions Regulator's *Code of Practice No 14* states:  
*'Schemes should establish and maintain policies and arrangements for acquiring and retaining knowledge and understanding to support their pension board members. Schemes should designate a person to take responsibility for ensuring that a framework is developed and implemented.'*

## 2. Policy and Legislative Background

- 2.1** On 1 April 2015, the governance structure of the LGPS fundamentally changed as a result of new governance requirements introduced by *The Local Government Pension Scheme (Amendment) (Governance) Regulations 2015*.
- 2.2** These changes have their origins in the final recommendations of the Independent Public Service Pensions Commission (IPSPC) chaired by Lord Hutton of Furness. In June 2010 the IPSPC was formed to undertake a fundamental structural review of public service pension provision and to make recommendations to the chancellor and chief secretary on future pension arrangements. The IPSPC produced an interim report in October 2010 and a final report in March 2011<sup>6</sup>.
- 2.3** In the final report, the Commission concluded that (page 126):
- ‘scheme members in all the public services should be able to nominate persons to pension boards and committees along similar lines to the rights of members in the private sector to nominate persons to sit on boards of trustees. Pension boards should therefore include independent professionals and scheme members in similar proportions as apply in the private sector to boards of trustees. It is also very important that as well as the “lay persons” there are also independent members, usually professionally trained and with experience of the pensions environment.’*
- 2.4** The Commission went on to make the following recommendation:
- ‘Every public service pension scheme (and individual LGPS fund) should have a properly constituted, trained and competent pension board, with member nominees, responsible for meeting good standards of governance, including effective and efficient administration (recommendation 17a).’*
- 2.5** The Commission’s recommendation was taken forward in the drafting of the *Public Service Pensions Bill* (subsequently the *Public Service Pensions Act 2013*).
- 2.6** Under Regulation 5 of the *Public Service Pensions Act 2013*, the responsible authority<sup>7</sup> for each public service pension scheme established under the 2013 Act is required to make

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6. [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/207720/hutton\\_final\\_100311.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207720/hutton_final_100311.pdf)

7. The “responsible authority” for each public service pension scheme is defined in Regulation 2 of the *Public Service Pensions Act 2013* as ‘the person who may make scheme regulations.’ For local government in England and Wales, this is set out in Schedule 2 of the Act as the secretary of state (DCLG).

provision in scheme regulations that requires each pension scheme manager<sup>8</sup> to establish a pension board to assist the scheme manager in relation to the following:

- (a) securing compliance with the scheme regulations and other legislation relating to the governance and administration of the scheme and any statutory pension scheme that is connected with it;*
- (b) securing compliance with requirements imposed in relation to the scheme and any connected scheme by the Pensions Regulator;*
- (c) such other matters as the scheme regulations may specify.'*

**2.7** Regulation 5 further directs that the scheme manager must include within its own scheme regulations provisions that require the scheme manager:

- (i) to be satisfied that a person to be appointed as a member of the board does not have a conflict of interest, and*
- (ii) to be satisfied from time to time that none of the members of the board has a conflict of interest;*
- (iii) ensure that a member of the board, or a person proposed to be appointed as a member of the board, be able to provide the scheme manager with such information as the scheme manager reasonably requires for the purposes of provision under the above;*
- (iv) ensure that the board include employer representatives and scheme member representatives in equal numbers.'*

**2.8** As required under Regulation 5, the Department for Communities and Local Government (DCLG) laid an amendment to the *Local Government Pension Scheme Regulations 2013* on 28 January 2015, setting out the arrangements for establishing pension boards in the LGPS<sup>9</sup>. The relevant Regulations (Regulations 105 to 109 of the *Local Government Pension Scheme Regulations 2013* (as amended) are reproduced in full at Annex C for ease of reference.

**2.9** A working group of the Shadow LGPS Scheme Advisory Board Governance and Standards Subcommittee has produced detailed guidance to scheme managers (administering authorities) to assist them in establishing local pension boards. This guidance can be found at [www.lgpsboard.org/index.php/about-the-board/board-guidance](http://www.lgpsboard.org/index.php/about-the-board/board-guidance)

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8. Regulation 4 of the *Public Service Pensions Act 2013* requires that public service pension schemes established under this Act (such as the LGPS from 1 April 2014) set out in scheme regulations who will be responsible for managing or administering the scheme. In the case of the LGPS, Regulation 53 of the *Local Government Pension Scheme Regulations 2013* sets out that each administering authority is designated the “scheme manager” for their fund.

9. *The Local Government Pension Scheme (Amendment) (Governance) Regulations 2015.*



# 3. Key Skills

- 3.1 The CIPFA Pensions Panel, with input from technical specialists covering each element of the skills matrix, has identified the key skills that lie at the core of successful public sector pension scheme administration.

## SCOPE OF THE FRAMEWORK

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- 3.2 Due to the complexity of pensions administration, these skill sets extend across several disciplines from accountancy and audit into areas of investment and actuarial finance, as well as knowledge of the legislative and governance environment. In total there are eight areas of knowledge and skills that have been identified as the core technical requirements for those working in public sector pensions finance. They are:

- pensions legislation
- public sector pensions governance
- pensions administration
- pensions accounting and auditing standards
- financial services procurement and relationship management
- investment performance and risk management
- financial markets and product knowledge
- actuarial methods, standards and practices.

These are expanded upon below.

- 3.3 The Institute recognises that there will of course be other technical (non-pensions related) and “softer” skills required in order to be competent in the role of a pension board member and Regulation 107 of the *Local Government Pension Scheme Regulations 2013* (as amended) makes specific reference to board appointees having the “capacity” to undertake the role. Whilst the Regulations do not define “capacity” in this context, the guidance referred to at paragraph 2.9 takes this to mean that board members should have ‘*time to commit to attend meetings, undertake training and effectively represent employers and (scheme) members (as appropriate).*’ The “soft” skills implied here are considered to be outside the scope of this framework but should also be considered when determining the ability of pension board members to effectively discharge their duties.

## PENSIONS LEGISLATION

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- 3.4 The pensions landscape is characterised by a complex legislative framework. In addition to the legislation of individual schemes, there are industry-wide statutes that apply in whole or in part to public sector schemes, including the way in which schemes interact with state pensions, the tax system, the Pensions Regulator etc.

- 3.5 A knowledge of this framework and the way in which it impacts upon the operations of individual schemes is key to understanding the context within which public sector pension schemes operate and the statutory obligations they are required to discharge.

## PUBLIC SECTOR PENSIONS GOVERNANCE

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- 3.6 On 1 April 2015, the governance structure that surrounds public sector pension schemes changed significantly. The *Public Service Pensions Act 2013* has introduced new bodies and relationships into what, in the LGPS in particular, was an already complex governance network.
- 3.7 Understanding how the pension board interacts with the other elements of this governance structure – the administering authority, the Scheme Advisory Board, the responsible authority (eg DCLG), the Pensions Regulator etc – and the various roles and responsibilities of those bodies is critical to the success of the board.
- 3.8 Also of key importance is a knowledge of the governance frameworks that apply within the wider pensions industry (such as the Myners principles and the *UK Stewardship Code* (FRC, 2010)); within individual schemes (such as the LGPS governance statement requirements); and within the organisations that administer the schemes (for example *Delivering Good Governance in Local Government: Framework* (CIPFA, 2007)).

## PENSIONS ADMINISTRATION

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- 3.9 Pensions administration is perhaps the most highly regulated area of the LGPS. Administering scheme benefits, contributions and other transactions is highly complex and is governed by extensive scheme regulations, as well as industry-wide requirements on disclosure, record-keeping, data maintenance, dispute resolution etc.
- 3.10 Understanding these requirements and assisting the administering authority to ensure compliance with the various regulations, standards and codes is a key role of the pensions board, which makes pensions administration a key strand of the knowledge and skills framework.

## PENSIONS ACCOUNTING AND AUDITING STANDARDS

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- 3.11 The way in which pension schemes are accounted for, both as a scheme and by the sponsoring employer(s), plays a significant part in the knowledge and skills framework. The accounting requirements and associated disclosures are complex and involve a large actuarial element. Consequently this demands an understanding of the regime in order to comply with the requirements and to communicate the requirements and their implications both internally and externally.
- 3.12 In addition, both internal and external auditors play a significant role in assuring that the administering authority complies with statutory requirements. Understanding the scope of their role, and the roles played by providers of third party assurance on outsourced services, is key for local pension board members.

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## PENSIONS SERVICES PROCUREMENT AND RELATIONSHIP MANAGEMENT

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- 3.13** Such are the scale, diversity and technical requirements of pensions operations, the use of outsourcing is commonplace. Whether it is the use of actuaries, fund managers, pensioner payroll providers or third party administrators, the skills and knowledge required to procure and manage outsourced services are central to scheme management in the public sector.
- 3.14** In some instances organisations will have specialist procurement units who will play a large part in the procurement process. In such cases many of the requirements of the framework may be met by virtue of the pension board member having access to external technical expertise. In these circumstances, users of the framework should adapt the level of detail in this skill set accordingly.

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## INVESTMENT PERFORMANCE AND RISK MANAGEMENT

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- 3.15** In the LGPS and other schemes where contributions are invested and managed to meet future liabilities, understanding investment risk and performance constitutes a major element of the role of pension board members.
- 3.16** Administering authorities are aware of the requirement to apply the same rigour to an assessment of their own performance and the performance of those who work on their behalf. Frameworks and targets must be devised and set, and performance monitored against them and reported to stakeholders. Pension board members should be equipped with a sufficient level of knowledge to enable them to assist the administering authority in ensuring that this is done effectively.

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## FINANCIAL MARKETS AND PRODUCT KNOWLEDGE

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- 3.17** In schemes with invested funds, an understanding of financial markets and products is fundamental. The depth of knowledge will depend to some degree upon the particular approach to investment management undertaken by the fund (the investment activities of LGPS funds for example can be split into two groups: those funds that use external managers to manage all of their investment portfolio; and those that undertake some or all of their investment activities using in-house investment managers).

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## ACTUARIAL METHODS, STANDARDS AND PRACTICES

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- 3.18** The scheme actuary holds a key position in the financial management of a pension scheme. Pension board members will need to understand, in some level of detail, the work of the actuary and the way in which actuarial information is produced and the impact it has on both the finances of the scheme and employers.

## THE KNOWLEDGE AND SKILLS FRAMEWORK

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**3.19** In the framework which follows, we have identified the key elements of expertise within each of the above areas of technical knowledge as they apply to pension board members. In addition, Annex D provides an example of how the framework can be used as an assessment tool for individuals.

# 4. Local Pension Boards: A Technical Knowledge and Skills Framework

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## **Pensions legislation**

A general understanding of the pensions legislative framework in the UK.

An overall understanding of the legislation and statutory guidance specific to the scheme and the main features relating to benefits, administration and investment.

An appreciation of LGPS discretions and how the formulation of the discretionary policies impacts on the pension fund, employers and local taxpayers.

A regularly updated appreciation of the latest changes to the scheme rules.

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## **Pensions governance**

Knowledge of the role of the administering authority in relation to the LGPS.

An understanding of how the roles and powers of the DCLG, the Pensions Regulator, the Pensions Advisory Service and the Pensions Ombudsman relate to the workings of the scheme.

Knowledge of the role of the Scheme Advisory Board and how it interacts with other bodies in the governance structure.

Broad understanding of the role of pension fund committees in relation to the fund, administering authority, employing authorities, scheme members and taxpayers.

Awareness of the role and statutory responsibilities of the treasurer and monitoring officer.

Knowledge of the Myners principles and associated CIPFA and SOLACE guidance.

A detailed knowledge of the duties and responsibilities of pension board members.

Knowledge of the stakeholders of the pension fund and the nature of their interests.

Knowledge of consultation, communication and involvement options relevant to the stakeholders.

Knowledge of how pension fund management risk is monitored and managed.

Understanding of how conflicts of interest are identified and managed.

Understanding of how breaches in law are reported.

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<b>Pensions administration</b>	<p>An understanding of best practice in pensions administration, eg performance and cost measures.</p> <p>Understanding of the required and adopted scheme policies and procedures relating to:</p> <ul style="list-style-type: none"> <li>■ member data maintenance and record-keeping processes</li> <li>■ internal dispute resolution</li> <li>■ contributions collection</li> <li>■ scheme communications and materials.</li> </ul> <p>Knowledge of how discretionary powers operate.</p> <p>Knowledge of the pensions administration strategy and delivery (including, where applicable, the use of third party suppliers, their selection, performance management and assurance processes).</p> <p>An understanding of how the pension fund interacts with the taxation system in the UK and overseas in relation to benefits administration.</p> <p>An understanding of what additional voluntary contribution arrangements exist and the principles relating to the operation of those arrangements, the choice of investments to be offered to members, the provider’s investment and fund performance report and the payment schedule for such arrangements.</p>
<b>Pensions accounting and auditing standards</b>	<p>Understanding of the Accounts and Audit Regulations and legislative requirements relating to internal controls and proper accounting practice.</p> <p>Understanding of the role of both internal and external audit in the governance and assurance process.</p> <p>An understanding of the role played by third party assurance providers.</p>
<b>Pensions services procurement and relationship management</b>	<p>Understanding of the background to current public procurement policy and procedures, and of the values and scope of public procurement and the roles of key decision makers and organisations.</p> <p>A general understanding of the main public procurement requirements of UK and EU legislation.</p> <p>Understanding of the nature and scope of risks for the pension fund and of the importance of considering risk factors when selecting third parties.</p> <p>An understanding of how the pension fund monitors and manages the performance of their outsourced providers.</p>
<b>Investment performance and risk management</b>	<p>Understanding of the importance of monitoring asset returns relative to the liabilities and a broad understanding of ways of assessing long-term risks.</p> <p>Awareness of the Myners principles of performance management and the approach adopted by the administering authority.</p> <p>Awareness of the range of support services, who supplies them and the nature of the performance monitoring regime.</p>

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<b>Financial markets and products knowledge</b>	<p>Understanding of the risk and return characteristics of the main asset classes (equities, bonds, property).</p> <p>Understanding of the role of these asset classes in long-term pension fund investing.</p> <p>Understanding of the primary importance of the investment strategy decision.</p> <p>A broad understanding of the workings of the financial markets and of the investment vehicles available to the pension fund and the nature of the associated risks.</p> <p>An understanding of the limits placed by regulation on the investment activities of local government pension funds.</p> <p>An understanding of how the pension fund interacts with the taxation system in the UK and overseas in relation to investments.</p>
<b>Actuarial methods, standards and practices</b>	<p>A general understanding of the role of the fund actuary.</p> <p>Knowledge of the valuation process, including developing the funding strategy in conjunction with the fund actuary, and inter-valuation monitoring.</p> <p>Awareness of the importance of monitoring early and ill health retirement strain costs.</p> <p>A broad understanding of the implications of including new employers into the fund and of the cessation of existing employers.</p> <p>A general understanding of the relevant considerations in relation to outsourcings and bulk transfers.</p> <p>A general understanding of the importance of the employer covenant and the relative strengths of the covenant across the fund employers.</p>

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# 5. Framework Status, Reporting and Compliance

## DEVELOPMENT AND MAINTENANCE

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- 5.1** This framework has been developed by the CIPFA Pensions Panel with input from technical specialists covering each element of the skills matrix.
- 5.2** As noted in chapter 1, it is the professional responsibility of the section 151 officer (or other named officer as appropriate) to establish and maintain policies and arrangements for acquiring and retaining knowledge and skills to support their pension board members. This professional requirement is in line with the requirement set out in paragraph 38 of the Pensions Regulator’s *Code of Practice No 14*. This framework is set down as good practice, in line with the previous CIPFA *Pensions Finance Knowledge and Skills Frameworks*, and is intended to assist practitioners in meeting their responsibilities under the CIPFA *Code of Practice on Public Sector Pensions Finance Knowledge and Skills* (2013), particularly principle 4.
- 5.3** The Pensions Panel is committed to maintaining and developing the framework as knowledge and skills requirements change over time. Any changes to the framework will go through the same process of expert review and user testing.

## REPORTING AND COMPLIANCE

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- 5.4** Statement 5 of the “statements to be adopted” in the CIPFA *Code of Practice on Public Sector Pensions Finance Knowledge and Skills* requires funds to report annually in their pension scheme annual reports on:
- how the knowledge and skills framework has been applied
  - what assessment of training needs has been undertaken
  - what training has been delivered against the identified training needs.

- 5.5 CIPFA recognises that in some cases members could be appointed to pension boards with little or no prior pensions knowledge. The chief officers and the chair should bear in mind the legal requirements as set out in the Pensions Regulator’s *Code of Practice No 14*<sup>10</sup> and have in place a plan that includes pre-induction training, leading into a fuller induction programme. These factors should be reflected in the training needs assessment and the delivery of training statement in the annual report.
- 5.6 Again, the CIPFA *Code of Practice on Public Sector Pensions Finance Knowledge and Skills* requirements are aligned with the guidance of the Pensions Regulator, whose *Code of Practice No 14* says this on the subject of demonstrating knowledge and understanding:
- ‘Schemes should keep appropriate records of the learning activities of individual pension board members and the board as a whole. This will help pension board members to demonstrate steps they have taken to comply with legal requirements and how they have mitigated risks associated with knowledge gaps. A good external learning programme will maintain records of the learning activities of individuals on the programme or of group activities, if these have taken place.’*
- 5.7 The Pension Regulator’s policy and approach to compliance is set out in its *Compliance and Enforcement Policy for Public Service Pension Schemes* (2015)<sup>11</sup>.
- Practitioners should familiarise themselves with this policy statement.

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10. Paragraphs 34 to 36 of the Pensions Regulator’s Code of Practice 14 state that:

*‘A member of the pension board of a public service pension scheme must be conversant with:*

- *the rules of the scheme, and*
- *any document recording policy about the administration of the scheme which is for the time being adopted in relation to the scheme.*

*A member of a pension board must have knowledge and understanding of:*

- *the law relating to pensions, and*
- *any other matters which are prescribed in regulations.*

*The degree of knowledge and understanding required is that appropriate for the purposes of enabling the individual to properly exercise the functions of a member of the pension board.’*

11. [www.thepensionsregulator.gov.uk/docs/compliance-policy-public-service-pension.pdf](http://www.thepensionsregulator.gov.uk/docs/compliance-policy-public-service-pension.pdf)

# 6. Achieving Framework Standards – Training and Support

- 6.1** To achieve the standards set down in the framework, organisations should as a first step consider undertaking a training needs assessment against the framework standards and developing appropriate training programmes.
- 6.2** The varied nature of training and the need to demonstrate continuous improvement in governance, places a high level of priority on forward planning through a business plan and a related training and development plan.
- 6.3** CIPFA working with Barnett Waddingham offer bespoke assessment, training, support and monitoring programmes for local pension boards and their members which are built around the requirements of this framework. This includes the following elements which can be taken as a whole or in part:
- **Assessment and planning**
    - Individual local pension board member knowledge, understanding and skills assessment.
    - Training plan/programme development.
  - **Training**
    - Pre-appointment and induction training.
    - Initial area specific training such as: pensions legislation and guidance; policies, procedures and working arrangements; overriding legislation and interacting statutory organisations; and investments and funding.
    - Ongoing and subject specific training such as regulatory changes and triennial valuations.
    - Annual refresher training and updates.
    - Member requested training.
    - Bespoke and open courses aimed at retention of knowledge and development of best practice.
  - **Support and mentoring**
    - Ongoing local pension board member mentoring, coaching and support.
    - BWebstream document access and storage system.
    - Training and support materials.
  - **Monitoring and reporting**
    - Ongoing individual local pension board member assessment.

- Monitoring local pension board member training and development, attendance and progress, maintaining records and reporting.

6.4 Please contact Annemarie Allen at Barnett Waddingham on 020 7776 3873 or via [annemarie.allen@barnett-waddingham.co.uk](mailto:annemarie.allen@barnett-waddingham.co.uk) or Nigel Keogh at CIPFA on 01204 592311 or via [nigel.keogh@cipfa.org](mailto:nigel.keogh@cipfa.org) to discuss your requirements in the first instance.

# 7. Further Reading and Sources of Guidance

## FROM CIPFA

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*Preparing the Annual Report: Guidance for Local Government Pension Scheme Funds* (2014)

*The Role of the Chief Financial Officer in the Local Government Pension Scheme* (2014)

*Code of Practice on Public Sector Pensions Finance Knowledge and Skills* (2013)

*Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom* (2012)

*Preparing and Maintaining a Funding Strategy Statement in the Local Government Pension Scheme* (2012)

*Managing Risk in the Local Government Pension Scheme* (2012)

*Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012* (2012)

*Buying Time: A CIPFA Pensions Panel Guide to Procuring Efficiency in Public Sector Pensions Administration* (2011)

*CIPFA Pensions Panel Guide to Stock Lending by Local Authority Pension Funds* (2011)

*CIPFA Pensions Panel Guide to Pension Fund Taxation in the United Kingdom* (2011)

*Narrative Reporting in Public Sector Pension Schemes* (2010)

*Delivering Good Governance in Local Government Pension Funds: A Guide to the Application of the CIPFA/SOLACE Code of Corporate Governance in Local Authorities to their Management of LGPS Funds* (2009)

*Guidance for Chief Finance Officers Administering LGPS Actuarial Valuations* (2008)

*CIPFA Pensions Panel: Weighing Up Risk Against Reward: An Introductory Guide to Asset-Liability Studies for Local Government Pension Funds* (2007)

*CIPFA Pensions Panel: Freedom of Information Act – Dealing with Requests for Information Relating to Local Authority Pension Funds* (2006)

## OTHER SOURCES

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*Code of Practice No. 14: Governance and Administration of Public Service Pension Schemes* (The Pensions Regulator, 2015)

*Compliance and Enforcement Policy for Public Service Pension Schemes* (The Pensions Regulator, 2015)

The Pensions Regulator also publishes a range of other helpful materials at [www.thepensionsregulator.gov.uk/public-service-schemes.aspx](http://www.thepensionsregulator.gov.uk/public-service-schemes.aspx)

*Local Government Pension Scheme (LGPS) – Guidance on the Creation and Operation of Local Pension Boards in England and Wales* (Shadow Scheme Advisory Board, 2015)

## OTHER TRAINING AND SUPPORT

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The CIPFA Pensions Network provides a range of seminars built around the themes in the *Pensions Finance Knowledge and Skills Frameworks*.

The Pensions Regulator also has an online “Public Service toolkit” available at [www.thepensionsregulator.gov.uk/public-service-schemes.aspx](http://www.thepensionsregulator.gov.uk/public-service-schemes.aspx)

# Annex A – Knowledge and Skills Responsibilities under the Pensions Regulator Code of Practice No 14

Where do knowledge and understanding responsibilities rest under the Code of Practice No 14?		Nature of requirement
Pension board member	Scheme manager	
<b>Legal requirements</b>		
Must be conversant with:		Statutory
<ul style="list-style-type: none"> <li>■ the rules of the scheme</li> <li>■ any document recording policy about the administration of the scheme which is for the time being adopted in relation to the scheme.</li> </ul>		
Must have knowledge and understanding of:		Statutory
<ul style="list-style-type: none"> <li>■ the law relating to pensions</li> <li>■ any other matters which are prescribed in regulations.</li> </ul>		
Should ensure that the degree of knowledge and understanding they possess is that appropriate for the purposes of enabling them to properly exercise the functions of a member of the pension board.		Statutory
<b>Practical guidance</b>		
	Should help pension board members meet their legal obligations.	Code of Practice (paragraph 37)
	Should establish and maintain policies and arrangements for acquiring and retaining knowledge and understanding to support their pension board members.	Code of Practice (paragraph 38)

**Where do knowledge and understanding responsibilities rest under the Code of Practice No 14? Nature of requirement**

Pension board member	Scheme manager	
	Should designate a person to take responsibility for ensuring that a framework for acquiring and retaining knowledge and skills is developed and implemented.	Code of Practice (paragraph 38)

**Areas of knowledge and understanding required**

	Should prepare and keep an updated list of the documents with which they consider pension board members need to be conversant. This will enable them to effectively carry out their role. They should make sure that both the list and the documents are available in accessible formats.	Code of Practice (paragraph 46)
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**Degree of knowledge and understanding required**

	Clear guidance on the roles, responsibilities and duties of pension boards and the members of those boards should be set out in scheme documentation.	Code of practice (paragraph 47)
	Should assist individual pension board members to determine the degree of knowledge and understanding that is sufficient for them to effectively carry out their role, responsibilities and duties as a pension board member.	Code of Practice (paragraph 48)

**Acquiring, reviewing and updating knowledge and understanding**

Should invest sufficient time in their learning and development alongside their other responsibilities and duties.	Should provide pension board members with the relevant training and support that they require.	Code of Practice (paragraph 55)
Newly appointed pension board members should be aware that their responsibilities and duties as a pension board member begin from the date they take up their post.	Should offer pre-appointment training or arrange for mentoring by existing pension board members	Code of Practice (paragraph 56)



Where do knowledge and understanding responsibilities rest under the Code of Practice No 14?		Nature of requirement
Pension board member	Scheme manager	
Should undertake a personal training needs analysis and regularly review their skills, competencies and knowledge to identify gaps or weaknesses.		Code of Practice (paragraph 57)
Should use a personalised training plan to document training needs.		Code of Practice (paragraph 57)
Pension board members who take on new responsibilities will need to ensure that they gain appropriate knowledge and understanding relevant to carrying out those new responsibilities.		Code of Practice (paragraph 58)
	<p>Learning programmes should:</p> <ul style="list-style-type: none"> <li>■ cover the type and degree of knowledge and understanding required</li> <li>■ reflect the legal requirements</li> <li>■ be delivered within an appropriate timescale.</li> </ul>	Code of Practice (paragraph 58)
Demonstrating knowledge and understanding		
	Should keep appropriate records of the learning activities of individual pension board members and the board as a whole.	Code of Practice (paragraph 59)



# Annex B – Suggested Job Description and Role Profile for the Chair of a Pensions Board

## PURPOSE OF ROLE

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To lead the pensions board in assisting the scheme manager in complying with legislation relating to the governance and administration of the scheme and any requirements imposed by the Pensions Regulator in relation to the scheme; and to ensure the effective and efficient governance and administration of the scheme.

## PRINCIPAL RESPONSIBILITIES

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- Ensure the board delivers its purpose as set out in the board's terms of reference.
- Prepare for and attend the local pension board meetings, agree the meeting agendas and approve the minutes.
- Scrutinise local pension board papers, lead discussions and provide advice and guidance to the board.
- Ensure that meetings are productive and effective and that opportunity is provided for the views of all board members to be expressed and considered.
- Seek to reach consensus and ensure decisions are properly put to a vote.
- Liaise with the scheme manager on the requirements of the board, including training requirements, budgeting and meeting dates, and lead on resolving member performance issues.
- Write reports required by the scheme manager on the performance of the board and related matters.
- Act as the principal point of contact with the Pensions Regulator, the Scheme Advisory Board and the responsible authority (eg DCLG) in all matters related to the operation of the board.

## PERSON SPECIFICATION

Requirement	Essential	Desirable
<b>1. Educational</b>		<p>Appropriate financial experience and training.</p> <p>Knowledge of pension funds and schemes.</p> <p>Demonstrable evidence of knowledge kept up-to-date.</p>
<b>2. Work experience</b>	<p>Chairing meetings, achieving effective outcomes.</p> <p>Experience of risk and performance frameworks.</p>	<p>Previously chaired a board or similar.</p>
<b>3. Abilities, intelligence and special aptitudes</b>	<p>Chairing skills.</p> <p>Influencing and consensus building.</p> <p>Listening skills.</p> <p>Able to assimilate complex information.</p>	<p>Mathematical/statistical literacy.</p> <p>Knowledge of public sector and local government finance.</p>
<b>4. Adjustment and social skills</b>	<p>Able to establish good working relationships with board members, councillors, officers and advisors.</p> <p>Able to direct discussions in politically sensitive environments.</p> <p>Able to command respect and demonstrate strong leadership.</p> <p>Able to achieve consensus when conflicting views arise.</p> <p>Able to challenge in a constructive manner.</p> <p>Assertive in pursuing the correct course of action.</p> <p>Able to work effectively with colleagues who may have different levels of experience and understanding.</p>	<p>Diplomacy and tact.</p>
<b>5. Motivation</b>	<p>Enthusiastic, not easily deterred and able to convey enthusiasm to others.</p> <p>Committed to the objectives of the pension scheme and fund(s).</p>	
<b>6. Equal opportunities</b>	<p>Understanding of and commitment to promoting equality of opportunity with an understanding of the pension context.</p>	

# Annex C – LGPS Governance Regulations 2014

## **PART 3**

### **Governance**

#### **Delegation**

- 105.**—(1) *The Secretary of State may delegate any function under these Regulations.*
- (2) *An administering authority may delegate any function under these Regulations including this power to delegate.*

#### **Local pension boards: establishment**

**106.**—(1) *Each administering authority shall no later than 1st April 2015 establish a pension board (“a local pension board”) responsible for assisting it—*

- (a) *to secure compliance with—*
- (i) *these Regulations,*
  - (ii) *any other legislation relating to the governance and administration of the Scheme and any connected scheme<sup>(a)</sup>, and*
  - (iii) *any requirements imposed by the Pensions Regulator in relation to the Scheme and any connected scheme; and*
- (b) *to ensure the effective and efficient governance and administration of the Scheme and any connected scheme.*
- (2) *Where the Scheme manager is a committee of a local authority the local pension board may be the same committee if approval in writing has been obtained from the Secretary of State.*
- (3) *Where the administration and management of a Scheme is wholly or mainly shared by two or more administering authorities, those administering authorities may establish a joint local pension board if approval in writing has been obtained from the Secretary of State.*
- (4) *Approval under paragraphs (2) or (3) may be given subject to such conditions as the Secretary of State thinks fit.*
- (5) *The Secretary of State may withdraw an approval if any conditions under paragraph (4) are not met or if in the opinion of the Secretary of State it is no longer appropriate for the approval to continue.*

(a) See section 4(6) of the Public Service Pensions Act 2013 for the definition of connected scheme.

- (6) Subject to paragraph (7), an administering authority may determine the procedures applicable to a local pension board, including as to the establishment of sub-committees, formation of joint committees and payment of expenses.
- (7) Except where a local pension board is a committee approved under paragraph (2), no member of a local pension board shall have a right to vote on any question unless that member is an employer representative or a member representative<sup>(b)</sup>.
- (8) A local pension board shall have the power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.
- (9) The expenses of a local pension board are to be regarded as part of the costs of administration of the fund held by the administering authority.

**Local pension boards: membership**

- 107.**—(1) Subject to this regulation each administering authority shall determine—
- (a) the membership of the local pension board;
  - (b) the manner in which members of the local pension board may be appointed and removed;
  - (c) the terms of appointment of members of the local pension board.
- (2) An administering authority must appoint to the local pension board an equal number, which is no less than 4 in total, of employer representatives and member representatives and for these purposes the administering authority must be satisfied that—
- (a) a person to be appointed to the local pension board as an employer representative has the capacity to represent employers; and
  - (b) a person to be appointed to the local pension board as a member representative has the capacity to represent members.
- (3) Except where a local pension board is a committee approved under regulation 106(2) (committee that is a Scheme manager is also local pension board)—
- (a) no officer or elected member of an administering authority who is responsible for the discharge of any function under these Regulations (apart from any function relating to local pension boards or the Local Government Pension Scheme Advisory Board) may be a member of the local pension board of that authority; and
  - (b) any elected member of the administering authority who is a member of the local pension board must be appointed as either an employer representative or a member representative.
- (4) Where a local pension board is a committee approved under regulation 106(2) (committee that is a Scheme manager is also local pension board) the administering authority must designate an equal number which is no less than 4 in total of the members of that committee as employer representatives and member representatives and for these purposes the administering authority must be satisfied that—
- (a) a person to be designated as an employer representative has the capacity to represent employers; and

(b) See section 5(6) of the Public Service Pensions Act 2013 for definitions of these terms.

- (b) *a person to be designated as a member representative has the capacity to represent members.*

**Local pension boards: conflict of interest**

- 108.**—(1) *Each administering authority must be satisfied that any person to be appointed as a member of a local pension board does not have a conflict of interest<sup>(a)</sup>.*
- (2) *An administering authority must be satisfied from time to time that none of the members of a local pension board has a conflict of interest.*
- (3) *A person who is to be appointed as a member of a local pension board by an administering authority must provide that authority with such information as the authority reasonably requires for the purposes of paragraph (1).*
- (4) *A person who is a member of a local pension board must provide the administering authority which made the appointment with such information as that authority reasonably requires for the purposes of paragraph (2).*

**Local pension boards: guidance**

**109.** *An administering authority must have regard to guidance issued by the Secretary of State in relation to local pension boards.*

*Source: The Local Government Pension Scheme (Amendment) (Governance) Regulations 2015*

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(a) *See section 5(5) of the Public Service Pensions Act 2013 for the meaning of “conflict of interest”.*





# Annex D – Example of Competency Self-assessment Matrix

## Local Pension Boards: A Technical Knowledge and Skills Framework: Learning needs analysis and training requirements

Learning needs analysis		Training requirements and plan	
Do I possess...?	Rate my skills	Training requirements	Training plan (sources and timing)
	1 – no knowledge 5 – highly skilled		
<b>1 – Pensions legislation</b>			
A general understanding of the pensions legislative framework in the UK.	1 2 3 4 5		
An overall understanding of the legislation and statutory guidance specific to the scheme and the main features relating to benefits, administration and investment.	1 2 3 4 5		
An appreciation of LGPS discretions and how the formulation of the discretionary policies impacts on the pension fund, employers and local taxpayers.	1 2 3 4 5		
A regularly updated appreciation of the latest changes to the scheme rules.	1 2 3 4 5		
<b>2 – Pensions governance</b>			
Knowledge of the role of the administering authority in relation to the LGPS.	1 2 3 4 5		
An understanding of how the roles and powers of the DCLG, the Pensions Regulator, the Pensions Advisory Service and the Pensions Ombudsman relate to the workings of the scheme.	1 2 3 4 5		

Learning needs analysis		Training requirements and plan	
Do I possess...?	Rate my skills	Training requirements	Training plan (sources and timing)
	1 – no knowledge 5 – highly skilled		
Knowledge of the role of the Scheme Advisory Board and how it interacts with other bodies in the governance structure.	1 2 3 4 5		
A broad understanding of the role of pension fund committees in relation to the fund, the administering authority, employing authorities, scheme members and taxpayers.	1 2 3 4 5		
An awareness of the role and statutory responsibilities of the treasurer and monitoring officer.	1 2 3 4 5		
Knowledge of the Myners principles and associated CIPFA and SOLACE guidance.	1 2 3 4 5		
A detailed knowledge of the duties and responsibilities of pension board members.	1 2 3 4 5		
Knowledge of the stakeholders of the pension fund and the nature of their interests.	1 2 3 4 5		
Knowledge of consultation, communication and involvement options relevant to the stakeholders.	1 2 3 4 5		
Knowledge of how pension fund management risk is monitored and managed.	1 2 3 4 5		
An understanding of how conflicts of interest are identified and managed.	1 2 3 4 5		
An understanding of how breaches in law are reported.	1 2 3 4 5		

Learning needs analysis	Training requirements and plan	
Do I possess...?	Rate my skills	Training requirements and plan
<b>3 – Pensions administration</b>	1 – no knowledge 5 – highly skilled	Training plan (sources and timing)
An understanding of best practice in pensions administration eg performance and cost measures.	1 2 3 4 5	
Understanding of the required and adopted scheme policies and procedures relating to: <ul style="list-style-type: none"> <li>■ member data maintenance and record-keeping processes</li> <li>■ internal dispute resolution</li> <li>■ contributions collection</li> <li>■ scheme communication and materials.</li> </ul>	1 2 3 4 5	
Knowledge of how discretionary powers operate.	1 2 3 4 5	
Knowledge of the pensions administration strategy and delivery (including, where applicable, the use of third party suppliers, their selection, performance management and assurance processes).	1 2 3 4 5	
An understanding of how the pension fund interacts with the taxation system in the UK and overseas in relation to benefits administration.	1 2 3 4 5	

Learning needs analysis	Training requirements and plan	
Do I possess...?	Rate my skills	Training plan (sources and timing)
<p>An understanding of what AVC arrangements exist and the principles relating to the operation of those arrangements, the choice of investments to be offered to members, the provider's investment and fund performance report and the payment schedule for such arrangements.</p>	<p>1 – no knowledge 5 – highly skilled</p> <p>1 2 3 4 5</p>	
<b>4 – Pensions accounting and auditing standards</b>		
<p>An understanding of the Accounts and Audit Regulations and legislative requirements relating to internal controls and proper accounting practice.</p>	<p>1 2 3 4 5</p>	
<p>An understanding of the role of both internal and external audit in the governance and assurance process.</p>	<p>1 2 3 4 5</p>	
<p>An understanding of the role played by third party assurance providers.</p>	<p>1 2 3 4 5</p>	
<b>5 – Pensions services procurement and relationship management</b>		
<p>An understanding of the background to current public procurement policy and procedures, and of the values and scope of public procurement and the roles of key decision-makers and organisations.</p>	<p>1 2 3 4 5</p>	

Learning needs analysis	Training requirements and plan
Do I possess...?	Training requirements and plan (sources and timing)
Rate my skills	Training requirements
1 – no knowledge 5 – highly skilled	
A general understanding of the main public procurement requirements of UK and EU legislation.	1 2 3 4 5
An understanding of the nature and scope of risks for the pension fund and of the importance of considering risk factors when selecting third parties.	1 2 3 4 5
An understanding of how the pension fund monitors and manages the performance of their outsourced providers.	1 2 3 4 5
6 – Investment performance and risk management	
An understanding of the importance of monitoring asset returns relative to the liabilities and a broad understanding of ways of assessing long-term risks.	1 2 3 4 5
An awareness of the Myners principles of performance management and the approach adopted by the administering authority.	1 2 3 4 5
Awareness of the range of support services, who supplies them and the nature of the performance monitoring regime.	1 2 3 4 5

Learning needs analysis	Training requirements and plan	
Do I possess...?	Rate my skills	Training requirements and plan
	1 – no knowledge 5 – highly skilled	Training plan (sources and timing)
<b>7 – Financial markets and products knowledge</b>		
An understanding of the risk and return characteristics of the main asset classes (equities, bonds, property etc).	1 2 3 4 5	
An understanding of the role of these asset classes in long-term pension fund investing.	1 2 3 4 5	
An understanding of the primary importance of the fund's statement of investment principles and the investment strategy decision.	1 2 3 4 5	
A broad understanding of the workings of the financial markets and of the investment vehicles available to the pension fund and the nature of the associated risks.	1 2 3 4 5	
An understanding of the limits placed by regulation on the investment activities of local government pension funds.	1 2 3 4 5	
An understanding of how the pension fund interacts with the taxation system in the UK and overseas in relation to investments.	1 2 3 4 5	

Learning needs analysis	Training requirements and plan	
Do I possess...?	Rate my skills	Training plan (sources and timing)
<b>8 – Actuarial methods, standards and practices</b>	1 – no knowledge 5 – highly skilled	
A general understanding of the role of the fund actuary.	1 2 3 4 5	
Knowledge of the valuation process, including developing the funding strategy in conjunction with the fund actuary, and inter-valuation monitoring.	1 2 3 4 5	
An awareness of the importance of monitoring early and ill health retirement strain costs.	1 2 3 4 5	
A broad understanding of the implications of including new employers into the fund and of the cessation of existing employers.	1 2 3 4 5	
A general understanding of the relevant considerations in relation to outsourcings and bulk transfers.	1 2 3 4 5	
A general understanding of the importance of the employer covenant and the relative strengths of the covenant across the fund employers.	1 2 3 4 5	







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# Agenda Item 7.7

Non-Executive Report of the: <b>PENSIONS COMMITTEE</b>  9 March 2016	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Zena Cooke, Corporate Director Resources	<b>Classification:</b> Unrestricted
<b>Pensions Committee Work Plan for 2016/17</b>	

<b>Originating Officer(s)</b>	Bola Tobun, Investment and Treasury Manager
<b>Wards affected</b>	All

## Summary

This report outlines the Work Plan for the Council's statutory function as the administering authority of the London Borough of Tower Hamlets Pension Fund.

Members of the Pensions Committee are required by the Council's Constitution to consider pension matters and meet the various statutory obligations and the duties of the Council. This Work Plan provides for certain statutory requirements to be met and for members to be well trained and kept up to date and thus fit for purpose.

## Recommendations:

Members are asked to:

- Agree the work plan attached as Appendix 1 to this report.

## **1. REASONS FOR THE DECISIONS**

- 1.1 Under the Local Government Pension Scheme (LGPS) Regulations, the Council is required to maintain a Pension Fund for its employees and other 'scheduled bodies' as defined in the Regulations. The Regulations also empower the Fund to admit employees of other 'defined' (e.g. other public bodies, housing corporations) bodies into the Fund.
- 1.2 The proposed work plan for the authority has been put together to assist in the management of the Fund, so that the Council is able to perform its role as the administering authority in a structured way. The Work Plan is not intended to cover all aspects of Pension Fund administration; rather it is designed to assist with meeting part of its delegated function as administering authority to the Fund.
- 1.3 The Pension Committee is charged with meeting the duties of the Council in respect of the Pension Fund. Therefore it is appropriate that the Committee formally adopts a work plan to assist with the discharge of its duties.

## **2. ALTERNATIVE OPTIONS**

- 2.1 The development and implementation of a work plan should ensure that a structured approach is in place for the monitoring and management of the Pension Fund. This should in turn ensure that the Council meets its statutory obligations as administering authority to the Fund. However, the Committee is under no obligation to adopt a work plan in carrying out its duties.

## **3. DETAILS OF REPORT**

- 3.1 The Council has specific delegated functions that it has to fulfil as the administering authority to the Pension Fund. This requires that a number of monitoring and management activities are undertaken to ensure that it fully discharges its oversight and governance responsibilities to the Fund.
- 3.2 It is appropriate that the Committee should set out how it intends to fulfil its obligations as the delegated authority appointed by the Council to be responsible for the Fund. Adopting a planned approach should make monitoring easier for the Committee and ensure that activities critical to the effective management of the Fund are being undertaken.
- 3.3 The Key Performance Indicators cover the following areas:
  - Investment performance
  - Funding level
  - Death benefit administration
  - Retirement administration
  - Benefit statements
  - New Joiners
  - Transfers in and out
  - Employer and member satisfaction
  - Data quality
  - Contributions monitoring
  - Overall administration cost
  - Audit

3.4 In line with best practice, future Pensions Committee meetings will be provided with a schedule of Pension Fund key performance indicators (KPIs) covering investment and administration practices.

3.5 An annual Work Plan will be presented to Committee for agreement. The Work Plan should be presented to Committee by the last committee meeting of the prior financial year to which the Work Plan applies.

### 3.6 WORK PLAN

3.6.1 In designing the work plan, the priorities of the Council as the administering authority of the Fund have been considered and incorporated into the Plan. The Work Plan has been developed using the below outline action plan.

ACTIVITY	PURPOSE
<b>Administration &amp; Governance</b>	
Member training on specific and general issues	To provide training on specific issues based on identified need or emerging/ current issues. To provide ongoing training to members to enable them to challenge the advice received and equip them with the tools to enter into constructive dialogue with advisers.
Pensions Committee to receive key performance indicators report on a quarterly basis.	To ensure scheme is run in accordance with agreed service standards; and compliance with regulations and to deal with and rectify any errors and complaints in a timely way.
Review the current pension administration strategy	To ensure scheme is run in accordance with the rules.
Review and refresh key policy documents; the Statement of Investment Principles, Funding Strategy Statement, Governance & Communications Policy Statement as necessary (i.e. where significant changes are made)	Seek member approval and formally publish any updated documents where this is deemed appropriate.
Set up pensions specific website or microsite	A pension specific website is scheduled to be set up towards the latter half of 2016, which will include details on pension administration, pension investments. And to provide a platform for on-line training facilities.
Minimum of four Pensions Committee meetings to be held during the financial year 2016/17.	To ensure that members are kept up to date on key developments with the London Borough of Tower Hamlets Pension Fund and to ensure that approval is received on key tasks/issues that affect the effective operation of the Fund.
Each Fund manager will attend at least one meeting during the year 2016/17 and more if deemed necessary	To oversee fund manager activities and monitor performance to ensure that they are achieving performance targets and investing fund assets within the confines of the risk parameters and approach agreed with the Council.

Ensure high level support is available to monitor and review, monitor and manage the risks taken by the Fund.	High level support is available via the Risk and Investment Management Team (RIMT) (this consists of officers and advisers) which oversees the implementation of the Pensions Committee decisions and as well as conceive and discuss new ideas for consideration by the Committee.
<b>Investment &amp; Accounting</b>	
Draft Pension Fund Annual Accounts approved by the Corporate Director of Resources in July 2016.	To ensure that the Council meets the regulatory timetable and fulfils its stewardship role to the Fund.
Audited Pension Fund Annual Report to be published on or before the statutory deadline of 1 December 2016	Ensure that the Council fulfils its statutory obligation and to keep members abreast of the Pension Fund activities in a transparent and accessible way.
Review of the Funds investment strategy	To ensure that the Fund's investment strategy is optimal. There are no current plans for a major investment strategy review over the financial year, although manager underperformance/ market developments may require a review of Strategy.
Review of (Actuarial, Investment Consultant and Independent Adviser and Custodian Services)	This may not lead to full re-tendering for these services, but reviews will be commissioned to ensure that the Fund is still receiving good value for its major services. All options will be considered in the review including joining existing framework contracts.
Triennial Valuation of Pension Fund Assets and Liabilities for March 2016	The Fund is bound by legislation to undertake an actuarial valuation of its assets and liabilities to ensure that appropriate future contribution rates are set and that any Fund deficit is recovered over an appropriate period of time in line with the Fund's Strategy Statement. This report will present to Members the outcome of this exercise.

#### **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

- 4.1 The comments of the Corporate Director of Resources are incorporated in the report.

#### **5. LEGAL COMMENTS**

- 5.1 Members of the Pensions Committee are required by the Council's Constitution to consider pension matters and meet the various statutory obligations and the duties of the Council. This Work Plan provides for certain statutory requirements to be met and for members to be well trained and kept up to date and thus fit for purpose.

- 5.4 When making decisions regarding investment of pension funds, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty).

## **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 The London Borough of Tower Hamlets Pension Fund represents an asset to the Council in terms of its ability for attracting and retaining staff who deliver services to residents. The adoption of a Work Plan should lead to more effective management of the Fund.
- 6.2 A significant element of the Council's budget is the employer's contribution to the Fund. Therefore, any improvement in the efficiency of the Fund that leads to improvement in investment performance or cost savings will likely reduce contributions from the Council and release funds for other corporate priorities.

## **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 A work plan and budget should result in a more efficient process of managing the Pension Fund.

## **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 The adoption of a work plan will minimise risks relating to the management of the Fund and should assist in managing down the risk of non-compliance with the Council's obligations under the Regulation as the administering authority of the London Borough of Tower Hamlets Pension Fund.

## **10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 10.1 There are no any crime and disorder reduction implications arising from this report.

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### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

- NONE

#### **Appendices**

- Appendix 1 – Pensions Committee Work Plan 2016/17

#### **Local Government Act, 1972 Section 100D (As amended)**

#### **List of "Background Papers" used in the preparation of this report**

- NONE

**Officer contact details for documents:**

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# PENSIONS COMMITTEE


## Work Plan

2016/17

Date of Meeting	Items	Title of Report / Presentation	Contact Officer
June 2016	1	Quarterly Performance Reporting of Fund Managers and update on emerging /current issues	Investment & Treasury Manager
	2	Quarterly Administrative Key Performance Indicators Report	Pensions Manager
	3	Annual Review of Statement of Investment Principles and Funding Strategy Statement	Investment & Treasury Manager
	4	Production of Compliance Checklist for the Pensions Regulator Code of Practice	Investment & Treasury Manager/Pensions Manager
	5	Production of Risk Management Policy and Risk Register	Investment & Treasury Manager
	6	Production of Reporting Breaches Policy and Conflicts of Interest Policy	Investment & Treasury Manager
	7	Review of Governance Compliance Statement	Investment & Treasury Manager
	8	Review of Pensions Administration Policy	Pensions Manager
Separate Evening	9	Member Training - Presentation	Various
September 2016	1	Quarterly Performance Reporting of Fund Managers and update on emerging /current issues	Investment & Treasury Manager
	2	Quarterly Administrative Key Performance Indicators Report	Pensions Manager
	3	Review of actuarial, investment advice and custodial services	Investment & Treasury Manager
	4	Presentation on Annual Fund Performance	Investment & Treasury Manager/WM Company
	5	Review of Communications Policy Statement	Pensions Manager

	6	Review Fund Managers performance and costs	Investment & Treasury Manager
	7	Review of Funding Strategy Statement	Investment & Treasury Manager
	8	Review of AVC Provision	Investment & Treasury Manager
	9	Member Training - Statement of Accounts training	Investment & Treasury Manager
November 2016	1	Quarterly Performance Reporting of Fund Managers and update on emerging /current issues	Investment & Treasury Manager
	2	Quarterly Administrative Key Performance Indicators Report	Pensions Manager
	3	Review/Approval of Annual Report	Investment & Treasury Manager
	4	Review of Fund Managers' internal control (SAS70)	Investment & Treasury Manager
	5	Review of actuarial, investment advice and custodial services	Investment & Treasury Manager
	6	Triennial Valuation of the Fund as at March 2016	Hymans - Actuary
	7	Review of Statement of Investment Principles	Investment & Treasury Manager
	8	Review of TPR Compliance Checklist	Investment & Treasury Manager/Pensions Manager
March 2017	1	Quarterly Performance Reporting of Fund Managers and update on emerging /current issues	Investment & Treasury Manager
	2	Quarterly Administrative Key Performance Indicators Report	Pensions Manager
	3	Presentation from Fund Manager	
	4	Consideration of Governance Compliance Statement (if necessary)	Investment & Treasury Manager

	5	Review of Communications Policy Statement	Pensions Manager
	6	Review of Pensions Administration Policy	Pensions Manager
	7	Pension Fund Work Plan and Budget 2017/18	Investment & Treasury Manager
	8	Review of AVC Provision	Investment & Treasury Manager

Non-Executive Report of the: <b>PENSIONS COMMITTEE</b>  9 March 2016	
<b>Report of:</b> Zena Cooke, Corporate Director Resources	<b>Classification:</b> Unrestricted
<b>The Council Responses to the Government Investment Reform Criteria &amp; Guidance and the Consultation on the Reformation of Investment Regulations</b>	

<b>Originating Officer(s)</b>	Bola Tobun, Investment and Treasury Manager
<b>Wards affected</b>	All

**Summary**

This report provides the Committee with information on the long awaited Government reform for investments and also on pooling of investments and the criteria and guidance surrounding this. At the same time the Government has also issued a consultation to amend the Investment Regulations which will help accommodate the changes being proposed for pooling. And how this might impact on the management of the Fund’s investments going forward.

**Recommendations:**

The Pensions Committee is recommended to:

- a) Note the Investment Reform Criteria and Guidance and a response to the proposals submitted 19th February 2016, attached to this report as Appendix 1;
- b) Note the consultation on Investment Regulations and a response to the proposals submitted 19th February 2016, attached to this report as Appendix 2.

## **1. REASONS FOR THE DECISIONS**

- 1.1 The Pensions Committee has delegated responsibility for managing all aspects of the Pension Fund and this includes setting investment strategy for the Pension Fund. The contents of this report demonstrate that the Committee is keeping informed of potential regulatory changes to the management of the Pension Fund and in particular in relation to its role in setting investment strategy. The draft regulations will require the Fund to set out a new Investment Strategy Statement which replaces the current Statement of Investment Principles.
- 1.2 The draft LGPS (Management and Investment of Funds) 2016 sets out proposals which would require the Fund to issue an Investment Strategy Statement in all likelihood by the 1st October 2016 having due regard to regulations and guidance assuming that the new regulations come into force on 1st April 2016 and the Board will have to consider this in due course when carrying out the duty of securing and ensuring compliance with regulations.

## **2. ALTERNATIVE OPTIONS**

- 2.1 This report highlights some fundamental changes to the way in which LGPS investments will be managed going forwards following on from the Government Criteria and Guidance along with the draft changes to the Investment Regulations. Given that Authorities are required to set out proposals as to how they will meet the Criteria and Guidance and the relatively short timescales for responding to such fundamental challenges, it is right and proper that the committee reviews and considers the issues highlighted by this report.
- 2.2 It is clear that the government expects all authorities in England and Wales to come forward with proposals as to how they propose to pool investments in the future and that those authorities that don't come forward with sufficiently ambitious plans for pooling could face compulsion under proposed backstop legislation contained in the draft revised investment regulations.

## **3. DETAILS OF REPORT**

- 3.1 The Criteria and Guidance issued by Government along with the consultation on changes to the Investment Regulations are likely to have far reaching financial implications for all LGPS funds in England and Wales.
- 3.2 Pooling of investments is targeted by government to lead to significant savings in the management of LGPS assets and it is hoped in due course that additional governance benefits will also at least maintain performance if not enhance. This will obviously impact on the Fund in terms of the costs incurred in the future.
- 3.3 As part of the required responses to the Criteria and Governance is a requirement on authorities to provide financial information on the level of savings that can be expected from pooling of investments both in the short term and over the longer term (15 years). These estimated savings are not required for the initial proposals on pooling to be submitted by 19th February,

but full financial information is required along with detailed proposals on pooling by the 15th July 2016.

- 3.4 London Borough of Tower Hamlets has been an active partner in the early and ongoing collaboration amongst London LGPS Funds to form the London Collective Investment Vehicle (CIV) and whilst there have been initial set up costs of £75,000 and a requirement for £150,000 Regulatory Capital Investment, these are expected to be relatively insignificant in terms of the longer term investment manager fee savings which the CIV will deliver.
- 3.5 Officers of the Council will work with the London CIV and other London Boroughs in order to provide realistic savings information for submission as part of the CIV's and Tower Hamlets' proposals for pooling for the 15th July 2016 submission deadline.
- 3.6 On 25th November 2015, the Government published its long awaited Investment Reform Criteria and Guidance (Appendix 3) alongside a consultation on new draft Investment Regulations (Appendix 5) to replace the 2009 LGPS (Management and Investment of Funds) Regulations.
- 3.7 This is the height of a considerable period of consultation and debate on the future for the management of pension funds in the LGPS. It started with the Hutton Review which commenced in 2010 looking at public service pension schemes and leading to the scheme changes in 2014. The government has also considered merger of LGPS funds along with requiring funds to invest the majority of assets passively and a consultation in 2014; Opportunities for collaboration, cost savings and efficiencies to which the Government received 200 responses. A Government response to this consultation (Appendix 7) has also now been issued alongside the Criteria and Guidance and draft investment Regulations.
- 3.8 Both the Investment Reform Criteria and Guidance and consultation on Investment Regulations seek responses firstly on how authorities plan to pool investments in outline and secondly whether the amended regulations provide sufficient flexibility for authorities to undertake pooling by 19th February 2016. Detailed proposals for pooling are then required by 15th July 2016.
- 3.9 Tower Hamlets has been involved in the establishment of the London CIV as way to deliver fee savings and wider governance benefits to funds in London. As such the authority is already participating in a pooled vehicle, which assuming that the funds who have already committed to the London CIV continue, means that this will meet crucial criteria for pooling including the requirement for at least £25bn of assets under management. However, given the detailed responses required of authorities and pools themselves, there remains a lot of work to do in order to be able to respond fully to Government by mid-July.
- 3.10 Copies of all the documentation are supplied as appendices to this report, with this report itself pulling out the key point raised in the documents.

## **INVESTMENT REFORM AND CRITERIA AND GUIDANCE**

3.11 The Government's proposals for Investment Reform Criteria and Guidance, is attached as appendix 3 to this report. This has not been issued as a consultation as the Criteria are predetermined and authorities are now being asked to respond to how they will work together to meet the criteria and guidance laid out in the paper. Initial responses to this are required by 19th February 2016 with detailed proposals to be submitted by 15th July 2016. The initial submissions from authorities should include a commitment to pooling and a description of their progress towards formalisation of their arrangements with other authorities with authorities being able to determine whether to submit individual or joint proposals or both. The submissions in July are expected to fully address the criteria set out by government comprising:

- i. for each pool, a joint proposal from participating authorities setting out the pooling arrangement in detail. For example, this may cover the governance structures, decision-making processes and implementation timetable; and
- ii. for each authority, an individual return detailing the authority's commitment to, and expectations of, the pool(s). This should include their profile of cost and savings, the transition profile for their assets, and the rationale for any assets they intend to hold outside of the pools in the long term.

3.12 The Chancellor had previously indicated in his July 2015 budget that he would work with authorities to ensure that LGPS investments in England and Wales would be pooled to significantly reduce costs, whilst maintaining investment performance. The initial indications were for 5-6 pools of investments of £25-30bn and that government would come forth with criteria and guidance in the autumn.

3.13 The government's objectives are clear in the Ministerial Foreword, although authorities have questioned the reference to British Wealth Funds – pointing out that there are distinct differences between the LGPS Funds which have long-term pension liabilities to meet, versus wealth funds, which don't and have often been built from the proceeds of natural resources tax receipts:

*“Working together, authorities have a real opportunity to realise the benefits of scale that should be available to one of Europe's largest funded pension schemes. The creation of up to six British Wealth Funds, each with at least £25bn of Scheme assets, will not only drive down investment costs but also enable the authorities to develop the capacity and capability to become a world leader in infrastructure investment and help drive growth.”*

3.14 The Pensions Committee were provided with an update on progress and the expected criteria at their Meeting in November. The four Criteria set out in the paper are as foreshadowed and the government requires authorities to address how they propose to meet these criteria:

- 1) **Asset Pool(s) that achieve the benefits of scale** – the 90 Administering Authorities in England and Wales should collaborate to establish and invest through pools of at least £25bn of assets. Authorities are therefore now required to explain:



- a. The size of their pool(s) once fully operational.
- b. In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
- c. The type of pool(s) they are participating in, including the legal structure if relevant.
- d. How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
- e. The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

2) **Strong Governance and decision making** – The proposed governance structure for the pools should:

- a. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
- b. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a longterm view, and a culture of continuous improvement is adopted.

And authorities are required to explain:

- i. The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
- ii. The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- iii. Decision making procedures at all stages of investment, and the rationale underpinning this.
- iv. The shared objectives for the pool(s), and any policies that are to be agreed between participants.
- v. The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
- vi. How any environmental, social and corporate governance policies will be handled by the pool(s).
- vii. How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
- viii. How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- ix. The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

3 **Reduced costs and excellent value for money** – Proposals are required to set out how the pool(s) will deliver substantial savings in investment fees both in the near term and over the next 15 years, whilst at the same time maintaining

investment performance. The criterion goes on to emphasise the active management should only be used where it can be shown to deliver value and authorities are required to report how fees and net performance in each listed asset class compare to a passive index. As part of the proposals submitted in July, authorities should provide:

- a. A fully transparent assessment of investment costs and fees as at 31 March 2013.
- b. A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- c. A detailed estimate of savings over the next 15 years.
- d. A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
- e. A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

4 **An improved capacity to invest in infrastructure** – Given the current low exposure to infrastructure, estimated at 0.3% compared to international comparisons of 10-15% of assets under management, the Government sees the scales that investment pools bring as offering real scope to increase the exposure to infrastructure assets. Authorities are therefore required as part of their submission to cover:

- a. The proportion of their fund currently allocated to infrastructure, both directly and through funds, or “fund of funds”.
- b. How they might develop or acquire the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or “fund of funds” arrangements.
- c. The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

3.15 The government emphasises that authorities whilst forming proposals, funds should continue to manage their investment strategies and any manager appointments until new arrangements are in place. To assist authorities in developing their proposals the Government has provided a copy of PwC’s technical analysis (attached as appendix 6 to this report) and in addition strongly encourages authorities to learn from others who have already begun the journey of developing collective investment vehicles such as the London CIV and the LPFA/Lancashire venture.

3.16 Other points to note in the criteria and guidance:

- i. Government expects all administering authorities to pool their investments to achieve economies of scale and the wider benefits of sharing best practice.
- ii. It expects no more than six large asset pools each with at least £25bn of LGPS assets under management. There may be limited scope to allow smaller pools but only for bespoke circumstances such as a particular asset class e.g. infrastructure or other illiquid assets.
- iii. The Government agrees that the democratic link between the authority and the running of the Scheme remains important and should not be removed by the pooling of investments. When developing a pool, authorities should ensure that there remains a clear link through the governance structure adopted, between the pool and the Pensions Committee.
- iv. Strategic asset allocation remains with the Administering Authority but that the implementation of that strategy will be delegated to officers or the pool. Manager selection will need to be undertaken at the pool level.
- v. When developing proposals, authorities need to take into consideration procedures and mechanisms to facilitate long term responsible investing and stewardship through the pool.
- vi. Enacting of environmental, social and corporate governance policy (ESG) should be taken into consideration both at an individual authority and pool level and how the authority's individual views can be reflected through the pool. In addition the Government intends to issue guidance to authorities that ESG policies should not run counter to Government policy (see investment consultation).
- vii. Whilst no specific savings target from the proposals has been set, authorities are expected to come forward with estimated savings, there are clear references to the savings suggested in the Hymans Report. These include:
  - a. £230m annual fee savings from passive; £190m p.a. from lower transaction costs; £240m p.a. from use of collective investment vehicles instead of "fund of funds" for illiquid assets.
  - b. Reference also made to LPFA's 75% fee savings from moving to internal management and £16m savings from shared procurements from the National Procurement Framework so far.
- viii. The extent to which passive management is used will remain a decision for each authority or pool, but authorities are encouraged to keep their balance of active and passive management under review.
- ix. The Scheme Advisory Board is commissioning advice to help authorities fully assess all investment costs which should be taken into account when coming forward with proposals.
- x. Developing larger investment pools will make it easier to develop or acquire improved capacity and capability to invest in infrastructure. The Government

believes that authorities can play a leading role in UK infrastructure and driving local growth.

- 3.17 The London Borough of Tower Hamlets Pension Fund has been working closely with other London Boroughs, in developing the London CIV and this will help frame the response that the authority is able to submit. The work undertaken by the London CIV has been recognised in the criteria for reform and has helped to form the debate around collective investment vehicles. Whilst recognising that London has led in this field, the criteria and guidance still require considerable resources to deliver the Government's agenda for reform.

### **CONSULTATION – REVOKING AND REPLACING THE LGPS (MANAGEMENT AND INVESTMENT OF FUNDS) REGULATIONS 2009**

- 3.18 The consultation on revoking and replacing the LGPS Investment Regulations and draft LGPS (Management and Investment of Funds) Regulations 2016, are attached as appendix 4 and 5 to this report.
- 3.19 Amending or replacing the Investment Regulations has been under discussion for a number of years and with the requirement for pooling, this has reinforced the need to amend the existing investment regulations. The consultation proposes to relax the current regulatory framework, but to introduce safeguards. The Chancellor's July Budget indicated that measures should be introduced to ensure that those authorities who do not bring forward ambitious proposals for pooling, in keeping with the Criteria (outlined in the previous section) should be required to pool.
- 3.20 The consultation proposes to revoke and replace the LGPS (Management and Investment of Funds) Regulations 2009 with there being 2 areas of reform, namely:
- a. A package of reforms that propose to remove some of the existing prescribed means of securing a diversified investment strategy and instead place the onus on authorities to determine the balance of their investments and take account of risk. (Proposal 1)
  - b. The introduction of safeguards to ensure that the more flexible legislation proposed is used appropriately and that the guidance on pooling assets is adhered to. This includes a suggested power to allow the Secretary of State to intervene in the investment function of an administering authority when necessary. (Proposal 2)
- 3.21 The Government is seeking views on whether the revisions will enable sufficient flexibility for authorities to determine a suitable investment strategy that appropriately takes account of risk. Further whether the proposals for safeguards being proposed and the scope for intervention by the Secretary of State will help to ensure that authorities are able to access the benefits of scales offered by pooling.
- 3.22 **Proposal 1: Adopting a local approach to investment** – In coming forward with this proposal the Government is seeking to deregulate and simplify the investment regulations removing a number of restrictions, e.g. the

requirement for funds to ensure an adequate number of managers and removing restrictions around the choice and terms of investment manager appointments. The proposals will also see the removal of the existing schedule of limitations on investments with authorities expected instead to adopt a 'prudential' approach, demonstrating they have given consideration to the suitability of different types of investments, have appropriate diversification and risk management. A new Investment Strategy Statement will be required of Funds, replacing the current Statement of Investment Principles.

3.23 The Investment Strategy Statement which authorities will be required to prepare and publish; having taken proper advice will need to cover:

- a. A requirement to use a wide variety of investments.
- b. The authority's assessment of the suitability of particular investments and types of investments.
- c. The authority's approach to risk, including how it will be measured and managed.
- d. The authority's approach to collaborative investment, including the use of collective investment vehicles and shared services.
- e. The authority's environmental, social and corporate governance policy.
- f. The authority's policy on the exercise of rights, including voting rights, attached to its investments.

3.24 Authorities will be required to publish an Investment Strategy Statement no later than 6 months after the regulations come into force (expected to be 1<sup>st</sup> April 2016) and existing provisions in current regulations around restrictions will remain in force until such time as the authority publishes its first Statement.

3.25 **Proposal 1: Non-Financial Factors** – Included within the consultation is a section on non-financial factors, which it is felt important to highlight to Committee. For information, the relevant section is copied in full below:

- i. The Secretary of State has made clear that using pensions and procurement policies to pursue boycotts, divestments and sanctions against foreign nations and the UK defence industry are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government. The Secretary of State has said, "Divisive policies undermine good community relations, and harm the economic security of families by pushing up council tax. We need to challenge and prevent the politics of division."
- ii. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 already require administering authorities to publish and follow a statement of investment principles, which must comply with guidance issued by the Secretary of State. The draft replacement Regulations

include provision for administering authorities to publish their policies on the extent to which environmental, social and corporate governance matters are taken into account in the selection, retention and realisation of investments.

- iii. Guidance on how these policies should reflect foreign policy and related issues will be published ahead of the new Regulations coming into force. This will make clear to authorities that in formulating these policies their predominant concern should be the pursuit of a financial return on their investments, including over the longer term, and that, reflecting the position set out in the paragraph above, they should not pursue policies which run contrary to UK foreign policy.

**3.26 Proposal 2: Introducing a safeguard – Secretary of State Power of Intervention –** In proposing new flexibilities around investment under Proposal 1 to enable authorities to pool investments and access scale benefits, the Government is keen to ensure that such flexibilities are used appropriately. The consultation therefore proposes to introduce a power for the Secretary of State to intervene in the investment function of an Administering Authority if (s)he believes that it has not had regard to guidance and regulations. This represents the backstop legislation to which the Chancellor referred in his July budget Statement. In addition the draft power to intervene could be used to address authorities that do not bring forward proposals for pooling their assets in line with the published criteria and guidance.

**3.27 Proposal 2: Determining to intervene and process of intervention –** In reaching a decision on whether to intervene, the Secretary of State will need to consider evidence as to whether the authority has failed to have regard to the regulations or guidance issued under regulation, such evidence could include ignoring information on best practice, failing to follow investment regulations and guidance or undertaking a pension-related function poorly e.g. in respect of actuarial valuations where they are not consistent with other authority valuations. If the Secretary of State is satisfied that intervention is required, then (s)he can draw on external advice to determine what specific intervention might be necessary. Examples of types of intervention are provided in the consultation, but not limited to the following:

- i. Requiring an administering authority to develop a new investment strategy statement that follows guidance published under draft Regulation 7(1).
- ii. Directing an administering authority to invest all or a portion of its assets in a particular way that more closely adheres to the criteria and guidance, for instance through a pooled vehicle.
- iii. Requiring that the investment functions of the administering authority are exercised by the Secretary of State or his nominee.
- iv. Directing the implementation of the investment strategy of the administering authority to be undertaken by another body.

#### **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

4.1 The comments of the Corporate Director Resources are incorporated in the report.

## **5. LEGAL COMMENTS**

5.1 Proposed new regulations – The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (expected to come into force on the 1<sup>st</sup> April 2016) will deal a number of matters relating to local government pension funds. Under regulation 5, there will be restrictions on an administering authority borrowing money where the borrowing is likely to be repaid out of its pension fund. Regulation 7 introduces a requirement on an administering authority to formulate an investment strategy which must be in accordance with the guidance issued by the Secretary of State. The authority must take proper advice prior to formulating its strategy. The strategy replaces the statement of investment principles which an authority was previously required to produce. The strategy must include the following matters:

- (a) a requirement to invest fund money in a wide variety of investments;
- (b) the authority's assessment of the suitability of particular investment and types of investments;
- (c) the authority's approach to risk, including the ways in which risks are to be measured and managed;
- (d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
- (e) the authority's policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
- (f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

The authority must consult any persons it considers appropriate on the contents of its investment strategy.

5.2 Regulation 8 will give the Secretary of State the power to issue a direction to an administering authority. Such a direction will be issued if the Secretary of State is satisfied that the authority is failing to have regard to guidance issued under regulation 7 – the investment strategy statement. It should be noted that Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 will continue to apply to the authority until the date when the authority publishes its investment strategy statement. For the period starting on 1<sup>st</sup> April 2016 and ending on whichever is the earlier of the date when the authority publishes its investment strategy statement under regulation 7 or 30<sup>th</sup> September 2016, regulation 7 applies to an authority only to the extent necessary to enable the authority to formulate and publish its investment strategy statement.

5.3 In addition to the new regulations referred to above, the authority is now required to provide financial information to Secretary of State on the savings that can be achieved by the pooling of investments. The government has issued detailed Criteria and Guidance on investment reform and pooling of local government pension funds to which the Council has responded as

required. The Council has also sent a response to the proposed draft regulations.

- 5.4 When making decisions regarding investment of pension funds, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty).

## **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 The London Borough of Tower Hamlets Pension Fund represents an asset to the Council in terms of its ability for attracting and retaining staff who deliver services to residents. A proactive approach to the adoption of a new regulation should lead to a more effective management of the Fund.
- 6.2 A significant element of the Council's budget is the employer's contribution to the Fund. Therefore, any improvement in the efficiency of the Fund that leads to improvement in investment performance or cost savings will likely reduce contributions from the Council and release funds for other corporate priorities.

## **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 Contributing and having a better understanding of government proposals would allow a proactive and cost effective approach in embracing new regulation and guidance which should result in a more efficient process of managing the Pension Fund.

## **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 This will enable a timely over hauling of appropriate policy documents in order to minimise risks relating to non-compliance under the new Regulation as the council is the administering authority of the London Borough of Tower Hamlets Pension Fund.

## **10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 10.1 There are no any crime and disorder reduction implications arising from this report.

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### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

- NONE

#### **Appendices**



- Appendix 1 – LBTH Response: Local Government Pension Scheme: Investment Reform Criteria and Guidance
- Appendix 2 – LBTH Response: Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 Consultation
- Appendix 3 - Local Government Pension Scheme: Investment Reform Criteria and Guidance
- Appendix 4 - Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 Consultation
- Appendix 5 – Draft LGPS Investment of Funds Regulations 2016
- Appendix 6 – PwC Report: Design of the structure and governance of efficient and effective CIVs for LGPS Funds
- Appendix 7 - Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies – Consultation

**Local Government Act, 1972 Section 100D (As amended)**

**List of “Background Papers” used in the preparation of this report**

- NONE

**Officer contact details for documents:**

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[LGPSReform@communities.gsi.gov.uk](mailto:LGPSReform@communities.gsi.gov.uk)

**London Borough of Tower Hamlets – Initial Proposals to Government  
Re: Investment Reform Criteria and Guidance**

Dear Sirs

**Local Government Pension Scheme: Investment Reform Criteria and Guidance**

This is very much the initial response from the London Borough of Tower Hamlets to the criteria issued last November by the Department of Communities and Local Government (DCLG) which requires local authorities to respond by 19th February 2016, including a commitment to pooling and a description of progress towards formalising arrangements with other authorities.

A comprehensive response will be provided in time for the 15<sup>th</sup> July 2016 deadline.

Whilst we are fortunate in having made considerable progress in London, we would like to emphasise to Government that the scale of response required will entail considerable resources to provide a comprehensive answer at a time when Funds have to close accounts for 2015/16 as well as undertaking the triennial actuarial valuation.

As a shareholder in the London CIV, we believe that London Boroughs are able to demonstrate and deliver the Government's ambitious proposals for pooling early having set up the London CIV which is now fully authorised and already transition assets into the pool.

LB Tower Hamlets initial response in regard to the four criteria are stated below:

**A. Asset pool(s) that achieve benefits of scale:**

- i. 31 London Boroughs have formally signed up as shareholders in the London CIV, assets under management as at 31<sup>st</sup> March 2015 amount to £27.6bn. If all London Borough were to participate this would mean that the London CIV assets pooled could be in the region of £29.1bn. Clearly investment markets over the period since then have been volatile and therefore assets may fall short of the above numbers. Our position as the Administering Authority of an individual fund has been to participate in the CIV and we continue to believe that this is the most appropriate pool for the Fund to collaborate with.
- ii. Whilst it will undoubtedly take time to open individual funds on the CIV and for Boroughs to transition assets into the CIV, we believe that the London CIV would reach the critical quantity to achieve scale of benefits.
- iii. London CIV is currently undergoing what is called Phase 1 – Implementation and fund launch to deliver nine sub-funds. Almost a quarter (£260m) of our Fund assets will be transitioned to the CIV platform before the end of February 2016; this is a demonstration of the council commitment to London CIV pooling arrangement.

- iv. Even If it is assumed that at least 90 per cent of borough assets will eventually be invested through the CIV (recognising that some boroughs may have illiquid assets such as infrastructure and private equity or may wish to make the case for up to 10 per cent of their assets to remain outside of the CIV, investing with niche fund managers with no capacity to be on the CIV platform) then the government's threshold of each pool having assets of at least £25 billion will be met.
- v. In terms of establishing the London CIV, this has been undertaken by a combination of internal and external resources and we would anticipate that this would continue as the CIV develops, although we anticipate that internal resources within the CIV itself will grow.
- vi. The London CIV has been keeping DCLG informed of progress and is content to continue to do so. Individual funds have also kept their Pensions Committee informed of progress, with Chairs or Vice Chairs of Pensions Committee being Members of the Pensions Sectoral Joint Committee (PSJC).

**B. Strong Governance and decision making:**

- i. Government will be aware of the structure that the London CIV has established which includes the Pensions Sectoral Joint Committee (PSJC - comprising of London Pension Fund Chairs and Vice Chairs) as well as an Investment Advisory Committee (IAC - comprising of officers of the London funds) and that this helps to main the strong links and assurance with the local administering authorities. This ensures that the links with local democratic accountability for the London CIV are maintained. The PSJC agendas and minutes are also publicly available which enables external scrutiny of the work of the PSJC.
- ii. The company and fund structure chosen for the London CIV means that the company has to be accountable to its shareholders who all retain equal shares in the ownership and voting.
- iii. As government will be aware the London CIV pool already has dedicated resources working for the company with a Chief Executive, Investment Oversight Director, Operations Director as well as support staff. In addition the Company has a highly respected Non-Executive Board in place meeting the requirements for strong governance arrangements to be in place.
- iv. In addition the arrangements that the London CIV has already put in place with external providers including Northern Trust (asset service provider), Capita (operating model adviser) as well as having used expert advisers, Eversheds and Deloitte in the establishment of the CIV provides administering authorities with the assurance on both the set-up and ongoing operation of the London CIV.
- v. With regards to providing assurance on environmental, social and governance issues and how this will be handled by the pool, this has already been the subject of consideration by the company and the PSJC with an agreement that the London CIV should be a separate member of the Local Authority Pension Fund Forum (LAPFF) – a body which

represents the majority of views of local authority pension funds on these matters.

- vi. The London CIV is also currently considering how it will meet the requirements of the Stewardship Code and anticipates being a signatory to this in due course.
- vii. The IAC has also established a working group to look at the whole issue of ESG matters and how funds can best access this through the London CIV and how to assist funds in acting as long term responsible shareholders.
- viii. For individual funds, we will of course need to maintain our own policies in respect of ESG matters and this will comprise part of our new Investment Strategy Statement which replaces the Statement of Investment Principles later this year.

**C. Reduced costs and excellent value for money:**

- i. As an early participant in collaboration via the London CIV, the Fund has been keen to explore opportunities for fee savings from collaboration in addition to fee negotiations with individual managers outside this process.
- ii. We anticipate significant fee savings arising from the CIV over time, from scale and improved negotiations with managers. The first phase of the CIV looks to be delivering fee savings close to £3m p.a. for the funds that will be invested, whilst it is has to be recognised that the first phase represents relatively low cost asset classes with the majority being in passive asset classes. We expect that as more complex and expensive assets are added to the CIV that the fee savings will significantly increase over time.
- iii. In addition to the anticipated fee savings, we also expect wider governance benefits from information sharing and improved access to expertise at all levels. The PWC report for the Society of London Treasurers in 2012 estimated that an additional £85m could be delivered in terms of improved investment returns by delivering superior performance. Whilst clearly this is a figure which is open to some discussion, it does give an indication of what might be achieved for funds by greater collaboration and delivering improved performance across all funds.
- iv. Whilst recognising that 2013 could be considered as a starting point for when funds started to apply pressure to managers for fee reductions, funds have always been conscious of the need to deliver value for money and this has included fee negotiations both at the outset of the contract and also ongoing reviews and that is certainly the case for our fund.
- v. Funds clearly understand the need to look at the risk adjusted returns over the longer term and that it is the net value add that impacts on the fund's ability to pay pensions over the longer term. However, we remain very conscious to avoid knee jerk reactions when managers experience periods of underperformance and we are pleased to see the government has recognised this in asking for funds to consider what is achieved over

an appropriate longer term, rather than solely focusing on short term performance comparisons.

**D. An improved capacity to invest in infrastructure:**

- i. Funds across London currently hold little to no infrastructure assets and as a Fund we are no exception to that. Having limited resources to consider this asset class along with a perceived lack of suitable investments means that limited consideration has been given to this asset class. Being part of a larger pool with the capacity to look at these investments and to provide suitable opportunities for individual funds will mean that both we and other funds in London will have a greater capacity to invest in infrastructure.
- ii. Having scale of assets will enable the CIV to look at opportunities for infrastructure, either direct or as co-investments that would not have been open to us as an individual fund.
- iii. Determining the proportion of assets that the fund will invest in infrastructure in the future will depend on the opportunities that are available and will depend on the level of risk and reward available from those assets when compared against risk/reward in other asset classes.
- iv. However, as part of the pool, the fund's capacity to invest will be significantly increased both from a scale and knowledge perspective and the Pensions Committee will therefore be in a position to allocate assets in this area. Assuming that there are assets available with the right risk/return profile, there is no reason why the Fund would not be in a position to invest to a level comparable with international larger scale funds.

**In Conclusion**

We believe that the work that has been undertaken by the London Boroughs that have contributed to the development of the pool in London, the London CIV has been instrumental in driving forward the investment reform agenda in London. The scale of assets that we anticipate will be achieved in London is sufficiently large for the London CIV to meet one of the criteria for scale of £25bn over the timescales being required. We believe that we have developed both the appropriate structure for London funds and that the governance structures in place mean that local accountability and decision making on asset allocation are retained.

Consequently we strongly believe given the willingness and progress that London funds have made over the last 2 years means that we are able to meet the criteria under the government's reform agenda.

We recognise that further work is required, but that as funds we are in a strong position to be able to come forward with comprehensive proposals to meet the government's criteria and guidance when submitting these in July 2016.

[consultationcoordinator@communities.gsi.gov.uk](mailto:consultationcoordinator@communities.gsi.gov.uk)

**London Borough of Tower Hamlets - LGPS Consultation: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009**

Dear Sirs

We have considered the consultation on revoking and replacing the LGPS (Management and Investment of Funds) Regulations and are pleased to submit our comments and responses to the questions as stated below.

In summary, the council believe that the approach taken to deregulate and to simplify the regulations is the appropriate approach and will enable Funds to implement asset pooling more effectively. We do have concerns over the scale and scope of powers that are proposed in draft regulations.

***1. Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?***

The London Borough of Tower Hamlets is pleased to see the general review of the investment regulation. We believe that the deregulation will enable funds to pursue greater collaboration without fear of breaching limits on the levels of investments in pools.

We note the requirements under investment strategy statement in section 7 and the requirement for taking proper advice and in accordance with guidance to be issued. We would ask that **such guidance be fully consulted upon and available for Funds by the start of the new financial year** to assist with planning on how best to meet such guidance.

We note the government's reference to ensuring that authorities' investments are made prudently, but this does not appear in the regulations, will this be included within the guidance?

We are concerned that the draft regulations also state the investment strategy 'must be in accordance' with the guidance and that this is a change in approach from the usual comply or explain and we would have concerns about the powers referred to later in the consultation, whether for practical and rational reasons a fund does not accord with an area of guidance whether this leads to intervention. This is particularly the case when funds adopt a different view of prudence to either other funds or government's views. Until such guidance is issued, it is difficult to fully respond to this question, but we would seek a change of term to a 'comply or explain' basis for the guidance.

***2. Are there any specific issues that should be reinstated? Please explain why.***

Further to above comments which refer to re-instating the 'comply or explain' terminology in relation to guidance rather than it being 'must be in accordance'.

**3. Is six months the appropriate period for the transitional arrangements to remain in place?**

A 6 month timeframe for transitional arrangements would be adequate ordinarily, However, given the current workload for funds, that is working on detailed pooling arrangements in conjunction with the triennial valuations, makes a 6 months' timeframe unrealistic and does not give funds sufficient time to consider fundamental issues from pooling and also the valuation need to be reflected in any strategy.

A more realistic timeframe would be 31<sup>st</sup> March 2017 allowing the outcome of any investment strategy work both in connection with pooling and the valuation to be fully incorporated in our response.

**4. Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?**

It is good to have clarification that the use of derivatives, futures and options contracts count as investments, given that there has been some confusion over the nature of their use by LGPS funds historically. Given the fast moving nature of financial markets and the uses that such instruments might be put to in the future, it would seem anomalous to be too prescriptive on how these should be used, a mechanism which could in future seem too restrictive.

**5. Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?**

In recognising the additional flexibility that the draft regulations offer authorities, we are concerned about the far ranging powers of intervention.

If the adoption of guidance is on a 'comply or explain' basis then this would provide the Secretary of State with additional evidence. If the Fund has also taken 'proper advice' then assuming that this can be made available this could also provide an additional source of evidence along with any exempt minutes of Committee decision making.

**6. Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?**

The regulations as drafted (Regulation 8) are unclear on setting out timelines, either for the Secretary of State or indeed for the authority where intervention is taking place. A clear timeline for all parties will be essential to avoid funds operating in a vacuum for any period of time.

**7. Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?**

The Secretary of State's powers of intervention are too broad. We recognise that the additional flexibility given to authorities in managing their investments is a major relaxation of the current regulations and we do not believe that the policy intention at this stage is to intervene in the way that funds manage their investments. However, government policy objectives can change over time and the regulations as set out mean that the powers of intervention could at some point lead to a conflict of government policy over what the fund perceives to be its fiduciary responsibilities.



The question asks about 'proportionate intervention' and the draft regulations at 8(a) and 8(b) would seem to be going beyond 'proportionate' as directions. If part of the policy intention is to ensure that funds are participating in the new LGPS investment pools, then it would seem that this could be drafted more clearly without the need for what would appear to be an all-encompassing power to direct investments in LGPS funds.

***8. Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?***

There is the need for the Secretary of State to intervene in authorities where there is complete disregard for best practice, guidance or regulation, but without access to the guidance at this stage it is difficult to comment further.

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Department for  
Communities and  
Local Government

# Local Government Pension Scheme: Investment Reform Criteria and Guidance



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# Ministerial Foreword

At the summer Budget 2015, the Chancellor announced our intention to invite administering authorities to bring forward proposals for pooling Local Government Pension Scheme investments, to deliver significantly reduced costs while maintaining overall investment performance.

We have been clear for some time that the existing arrangements for investment by the Local Government Pension Scheme are in need of reform, and the announcement made plain our expectation that authorities would be ambitious when developing their proposals. The publication of these criteria and their supporting guidance marks a significant milestone on the road to reform, placing authorities in a strong position to take the initiative and drive efficiencies in the Scheme, and ultimately deliver savings for local taxpayers.

The Scheme is currently organised through 89 separate local government administering authorities and a closed Environment Agency scheme, which each manage and invest their assets largely independently. Recognising the potential for greater efficiency in this system, the coalition government first began to consider the opportunity for collaboration in 2013 with a call for evidence. Since then, we have been exploring the opportunities to improve; gathering evidence, testing proposals, and listening to the views of administering authorities and the fund management industry.

The Chancellor's announcement draws on this earlier work and in particular the consultation, *Opportunities for collaboration, cost savings and efficiencies*, published in May 2014 by the coalition government. More than 200 consultation responses and papers were received and analysed, leading to the development of a framework for reform that has administering authorities at its centre. The criteria published today make clear the Government's expectation for ambitious proposals for pooling, and invite authorities to lead the design and implementation of their own pools. The criteria have been shaped and informed by earlier consultations, as well as several conversations with administering authorities and the fund management industry which took place over the summer.

Working together, authorities have a real opportunity to realise the benefits of scale that should be available to one of Europe's largest funded pension schemes. The creation of up to six British Wealth Funds, each with at least £25bn of Scheme assets, will not only drive down investment costs but also enable the authorities to develop the capacity and capability to become a world leader in infrastructure investment and help drive growth. I know that many authorities have already started to consider who they will work with and how best to achieve the benefits of scale. These early discussions place those authorities on a strong footing to deliver against our criteria, and I look forward to seeing their proposals develop over the coming months.

**Marcus Jones**

# Criteria

1.1 In the July Budget 2015, the Chancellor announced the Government's intention to work with Local Government Pension Scheme (the Scheme) administering authorities to ensure that they pool investments to significantly reduce costs while maintaining overall investment performance. Authorities are now invited to submit proposals for pooling which the Government will assess against the criteria in this document. The Chancellor has announced that the pools should take the form of up to six British Wealth Funds, each with assets of at least £25bn, which are able to invest in infrastructure and drive local growth.

1.2 The following criteria set out how administering authorities can deliver against the Government's expectations of pooling assets.

1.3 It will be for authorities to suggest how their pooling arrangements will be constituted and will operate. In developing proposals, they should have regard to each of the four criteria, which are designed to be read in conjunction with the supporting guidance that follows. Their submissions should describe:

**A. Asset pool(s) that achieve the benefits of scale:** The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported. Authorities should explain:

- The size of their pool(s) once fully operational.
- In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
- The type of pool(s) they are participating in, including the legal structure if relevant.
- How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
- The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

**B. Strong governance and decision making:** The proposed governance structure for the pools should:

- i. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
- ii. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability. Authorities should explain:

- The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
- The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- Decision making procedures at all stages of investment, and the rationale underpinning this.
- The shared objectives for the pool(s), and any policies that are to be agreed between participants.
- The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
- How any environmental, social and corporate governance policies will be handled by the pool(s).
- How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

**C. Reduced costs and excellent value for money:** In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so are rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.

Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

As part of their proposals, authorities should provide:

- A fully transparent assessment of investment costs and fees as at 31 March 2013.
- A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- A detailed estimate of savings over the next 15 years.



- A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
- A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

**D. An improved capacity to invest in infrastructure:** Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class. Authorities should explain:

- The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
- How they might develop or acquire the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or "fund of funds" arrangements.
- The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

# Addressing the criteria

## Requirements and Timetable

2.1 Authorities are asked to submit their initial proposals to the Government to [LGPSReform@communities.gsi.gov.uk](mailto:LGPSReform@communities.gsi.gov.uk) by 19 February 2016. Submissions should include a commitment to pooling and a description of their progress towards formalising their arrangements with other authorities. Authorities can choose whether to make individual or joint submissions, or both, at this first stage.

2.2 Refined and completed submissions are expected by 15 July 2016, which fully address the criteria in this document, and provide any further information that would be helpful in evaluating the proposals. At this second stage, the submissions should comprise:

- for each pool, a joint proposal from participating authorities setting out the pooling arrangement in detail. For example, this may cover the governance structures, decision-making processes and implementation timetable; and
- for each authority, an individual return detailing the authority's commitment to, and expectations of, the pool(s). This should include their profile of costs and savings, the transition profile for their assets, and the rationale for any assets they intend to hold outside of the pools in the long term.

## Assessing the proposals against criteria

2.3 The Government will continue to engage with authorities as they develop their proposals for pooling assets over the coming months. The initial submissions will be evaluated against the criteria, with feedback provided to highlight areas that may fall outside of the criteria, or where additional evidence may be required.

2.4 Once submitted, the Government will assess the final proposals against the criteria. A brief report will be provided in response, setting out the extent to which the criteria have been met and highlighting any aspects of the guidance that the Government believes have not been adequately addressed. In the first instance, the Government will work with authorities who do not develop sufficiently ambitious proposals to help them deliver a more cost effective approach to investment that draws on the benefits of scale. Where this is not possible, the Government will consider how else it can drive value for money for taxpayers, including through the use of the "backstop" legislation, should this be in place following the outcome of the consultation described below.

## Transitional arrangements

2.5 Plans should be made to transfer assets to the pools as soon as practicable. Analysis commissioned by the Government from PricewaterhouseCoopers (PwC) indicates that, even those pooling mechanisms requiring supporting infrastructure, such as collective investment vehicles, could be established within 18 months. It is expected that liquid assets are transferred into the pools over a relatively short timeframe, beginning from April 2018. It is recognised that illiquid assets are likely to transition over a longer period of time. For the avoidance of doubt, investments with high penalty costs for early

exit should not be wound up early on account of the pooling arrangements, but should be transferred across as soon as practicable, taking into account value for money considerations. Any assets that are held outside of the pool should be kept under review to ensure that arrangement continues to provide value for money.

2.6 While authorities will need to be mindful of their developing pooled approach, they should continue to manage both their investment strategies and manager appointments as they do now until the new arrangements are in place. In keeping with the investment regulations, they are still responsible for keeping both under regular review.

### **Support to develop proposals**

2.7 To help authorities develop proposals quickly and efficiently, the Government has made available PwC's detailed technical analysis of the different collective investment vehicles and their tax arrangements at: <https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>. This paper is provided for information only. It does not represent the view of Government, and authorities should seek professional advice as needed when developing their proposals. Authorities are also strongly encouraged to learn from those who have already begun to develop collective investment vehicles, such as the London Boroughs or Lancashire and the London Pension Fund Authority.

## **Legislative context**

2.8 At the July Budget 2015, the Chancellor also announced the Government's intention to consult on "backstop" legislation that would require those administering authorities who do not come forward with sufficiently ambitious proposals to pool their assets with others. That consultation has now been published and is available on the Government's website at: <https://www.gov.uk/government/consultations/revoking-and-replacing-the-local-government-pension-scheme>.

2.9 The consultation proposes to introduce a power for the Secretary of State to intervene in the investment function of an administering authority where it has not had sufficient regard to guidance published by the Secretary of State. The intervention should be proportionate and subject to both consultation and review.

2.10 The draft regulations include a provision for the Secretary of State to issue guidance. Subject to the outcome of the consultation, authorities would then need to have regard to that guidance when producing their investment strategy. The Government proposes to issue this document as Secretary of State's guidance if the draft regulations come into effect. The guidance will be kept under review and may be updated, for example if the proposals for pooling that come forward are not sufficiently ambitious.

2.11 The consultation also proposes to replace and update the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 to make significant investment through pooled vehicles possible.

# Supporting guidance

3.1 This guidance is to assist authorities in the design of ambitious proposals for pooling investments and to provide ongoing support as they seek to ensure value for money in the long term. It will be kept under review to ensure that it continues to represent best practice.

## A. Asset pool(s) that achieve the benefits of scale

**Headline criterion:** The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported.

3.2 The consultation, *Opportunities for collaboration, cost savings and efficiencies*, set out strong evidence that demonstrated how using collective investment vehicles and pooling investments can deliver substantial savings for the Local Government Pension Scheme without affecting investment performance. Additional advantages to pooling, which should further reduce costs and improve decision making in the long term, include:

- Increasing the range of asset classes to be invested in directly,
- Strengthening the governance arrangements and in-house expertise available to authorities,
- Improving transparency and long-term stewardship, and
- Facilitating better dissemination of best practice and performance data between authorities.

### The case for collective investment

3.3 Published in May 2014, the analysis in the Hymans Robertson report evidenced that using collective investment vehicles could deliver savings. In the case of illiquid assets alone, they found that £240m a year could be saved if investments were channelled through a Scheme wide collective investment vehicle rather than the existing “fund of funds” approach.<sup>1</sup>

3.4 A review of the academic analysis available also supports the case for larger investment pools. For example, Dyck and Pomorski's paper, *Is Bigger Better? Size and performance in pension fund management*, established that larger pension funds were able to operate at lower cost than their smaller counterparts, through a combination of

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<sup>1</sup> Hymans Robertson report: *Local Government Pension Scheme structure analysis*, p.3  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/307926/Hymans\\_Robertson\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307926/Hymans_Robertson_report.pdf)

improved negotiating power, greater use of in-house management, and more cost effective access to alternative assets like infrastructure.<sup>2</sup>

A third to a half of the benefits of size come through cost savings realized by larger plans, primarily via internal management. Up to two thirds of the economies come from substantial gains in both gross and net returns on alternatives.

3.5 A number of respondents to the May 2014 consultation also set out the case for larger funds being able to access lower cost investments. London Councils, for example, estimated that savings of £120m a year could be delivered if £24bn was invested through the London collective investment vehicle (CIV), as a result of reduced investment management fees, improved performance, and enhanced efficiency.

3.6 Formal mechanisms of pooling, such as collective investment vehicles, offer additional benefits to alternative arrangements such as procurement frameworks. For example, Hymans Robertson explained that larger asset pools would increase the opportunities for buy and sell transactions to be carried out within the Scheme, reducing the need to go to the market and so minimising transaction costs. Their analysis found that this could reduce transaction costs, which erode the value of assets invested, by £190m a year.<sup>3</sup>

3.7 Pooling investments will also create an opportunity to improve transparency and information sharing amongst authorities. By having a single entity responsible for negotiating with fund managers and reporting performance, authorities can see what they are paying and generating in returns and how it compares with other authorities. Similarly, Lancashire County Pension Fund and the London Pension Fund Authority, who are developing a pool for assets and liabilities, anticipate economies of scale driving improved performance. They have recently estimated that by pooling they can achieve enhanced investment outcomes of £20-£30m a year from their current levels.<sup>4</sup>

### **Achieving appropriate scale**

3.8 The Government expects all administering authorities to pool their investments to achieve economies of scale and the wider benefits of sharing best practice.

3.9 A move to larger asset pools would also be in keeping with international experience. For example, in Ontario, smaller public sector pension funds are being required to come together to form pools of around \$50bn Canadian (approximately £30bn at the time the proposal was made). Similarly, Australian pension funds have been consolidating in recent years, where a formal review in 2010 recommended that each MySuper pension fund be required to consider annually whether they have sufficient scale and membership to continue as a separate pension fund.<sup>5</sup>

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<sup>2</sup> Dyck and Pomorski, *Is bigger better? Size and Performance in Pension Plan Management*, pp.14-15

<sup>3</sup> Hymans Robertson report, pp.14-15

<sup>4</sup> Sir Merrick Cockell, writing in the *Pensions Expert* on 30 September 2015

<sup>5</sup> Government Response to the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Recommendation 1.6,

3.10 The May 2014 consultation sought views on the number of collective investment vehicles to be established. Respondents stressed the importance of balancing the need for scale with local input and practical governance arrangements. It was also argued that while larger asset pools would deliver greater savings, the potential difficulties of successfully investing large volumes of assets in a single asset class, particularly active strategies for listed assets, should also be taken into account. However, while individual managers may restrict the value of assets they are prepared to accept or are able to invest, the selection of a few managers for each asset class would help to mitigate this risk.

3.11 Having reflected on the views expressed in response to the consultation and the experience of pension funds internationally, the Government believes that in almost all cases, fewer, larger assets pools will create the conditions for lower costs and reduce the likelihood of activity being duplicated across the Scheme, for example by minimising pooled vehicle set-up and running costs. It therefore expects authorities to collaborate and invest through no more than six large asset pools, each with at least £25bn of Local Government Pension Scheme assets under management once fully operational.

3.12 However, the Government recognises that there may be a limited number of bespoke circumstances where an alternative arrangement may be more appropriate for a particular asset class or specific investment. As set out below, this may include pooling to invest in illiquid assets like infrastructure, direct holdings in property and locally targeted investments.

### **Investment in infrastructure and other illiquid or alternative assets**

3.13 The Hymans Robertson report highlighted illiquid or alternative assets as an area for significant savings for the Scheme. They found that in 2012-2013, illiquid asset classes like private equity, hedge funds and infrastructure represented just 10% of investments made, but 40% of investment fees. They also demonstrated that changing the way these investments are made, moving away from “fund of funds” to a collective investment vehicle, could save £240m a year.<sup>6</sup>

3.14 The Government expects the pooling of assets to remove some of the obstacles to investing in these asset classes in a cost effective way. A separate criterion has been included on infrastructure, although similar benefits exist for other alternative or illiquid assets, such as private equity, venture capital, debt funds and new forms of alternative business finance. In light of this, authorities should consider how best to access these asset classes in a more cost-effective way. Regionally based pools, such as the London boroughs’ collective investment vehicle, would allow authorities to make best use of existing relationships, while a single national pool for infrastructure or illiquid assets would deliver even greater scale and opportunity for efficiency.

3.15 A considerable shift in asset allocation would be needed to develop a pool of £25bn for investment in infrastructure and other illiquid or alternative assets, such as private equity or venture capital. The Government recognises that such a significant movement in

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[http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government\\_response/recommendation\\_response\\_chapter\\_1.htm](http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government_response/recommendation_response_chapter_1.htm)

<sup>6</sup> Hymans Robertson report, p.24

asset allocation is unlikely in the near term. As such, should authorities elect to develop a single asset pool for illiquid investments or infrastructure, the Government recognises that a value of assets under management less than £25bn might be appropriate.

### **Investments outside of the pools**

3.16 The Government's presumption is that all investments should be made through the pool, but we recognise that there may be a limited number of existing investments that might be less suitable to pooled arrangements, such as local initiatives or products tailored to specific liabilities. Authorities may therefore wish to explore whether to retain a small proportion of their existing investments outside of the pool, where this can demonstrate clear value for money. Any exemptions should be minimal and must be set out in the pooling proposal, alongside a supporting rationale.

### **Property**

3.17 As of the 31 March 2014, authorities reported that they were investing around 2.5% of their assets in directly held property, with a further 4.1% invested through property investment vehicles.<sup>7</sup> However, the amount invested varies considerably between authorities, with some targeting investment of around 10% of their assets in direct holdings, for example.

3.18 A number of consultation responses stressed the importance of retaining direct ownership of property outside of any pooled arrangement, a view echoed in our discussions with interested parties over the summer. Directly held property is used by some authorities to match a particular part of an authority's liabilities, or to generate regular income. If these assets were then pooled, while the authority would receive the benefits of the pooled properties, there is a risk that this would not match the liability or cash-flow requirements that had underpinned the decision to invest in a particular property.

3.19 In light of the arguments brought forward by authorities and the fund management industry, the Government is prepared to accept that some existing property assets might be more effectively managed directly and not through a pool at present. However, pools should be used if new allocations are made to property, taking advantage of the opportunity to share the costs associated with the identification and management of suitable investments.

3.20 Where authorities invest more than the reported Scheme average of 2.5% in property directly, they should make this clear in their pooling submission.

### **Addressing the criterion**

3.21 When developing their proposals for pooling, authorities should set out:

- The size of their pool(s) once fully operational.
- In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.

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<sup>7</sup> Scheme Advisory Board, Annual Report <http://www.lgpsboard.org/index.php/investment-performance-2014>

- The type of pool(s) they are participating in, including the legal structure if relevant.
- How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
- The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.



## B. Strong governance and decision making

**Headline criterion:** The proposed governance structure for the pools should:

- i. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
- ii. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability.

3.22 A number of consultation responses stressed the importance of establishing strong governance arrangements for pools. Securing the right balance between local input and timely, effective decision making was viewed as essential, but also a significant challenge. The management and governance arrangements of each pool will inevitably be defined by the needs of those participating. However, there are some underlying principles that the Government believes should be incorporated.

### **Maintaining democratic accountability**

3.23 The May 2014 consultation was underpinned by the principle that asset allocation should remain with the administering authorities. Consultation respondents were strongly in favour of retaining local asset allocation, noting that each fund has a unique set of participating employers, liabilities, membership and cash-flow profiles, which need to be addressed by an investment strategy tailored to those particular circumstances.

3.24 Respondents also highlighted the transparency and accountability benefits offered by local asset allocation. If councillors are responsible for setting the investment strategy, then local taxpayers, who in part fund the Scheme through employer contributions, have an opportunity to hold their decisions directly to account through local elections. As one consultation response explained:

The accountability of Members of the employing authorities playing a part in deciding locally how the assets of the Pension Fund are allocated is important. Employer contributions are paid, in the main, by local council tax payers who in turn vote for their local councillors. Those councillors should have the autonomy to make decisions relating to the investment strategy of that Pension Fund.

3.25 The Government agrees that this democratic link is important to the effective running of the Scheme and should not be wholly removed by the pooling of investments. As set out below, determining the investment strategy and setting the strategic asset allocation should remain with individual authorities. When developing a pool, authorities should ensure that there remains a clear link through the governance structure adopted, between the pool and the pensions committee. For example, this might take the form of a shareholding in the pool for the authority, which is exercised by a member of the pension committee.

## **Strategic asset allocation**

3.26 Establishing the right investment strategy and strategic asset allocation is crucial to optimising performance. It is increasingly accepted that strategic asset allocation is one of the main drivers of investment returns, having far greater an impact than implementation decisions such as manager selection.

3.27 The majority of respondents to the May 2014 consultation supported local asset allocation, but discussions with interested parties over the summer have highlighted a lack of consensus as to what constitutes strategic asset allocation. Definitions have ranged from selecting high level asset classes such as the proportions in bonds, equities and property; to developing a detailed strategy setting out the extent and types of investments in each of the different equity or bond markets.

3.28 Informed by these discussions with fund managers and administering authorities, the Government believes that pension committees should continue to set the balance between investment in bonds and equities, recognising their authority's specific liability and cash-flow forecasts. Beyond this, it will be for each pool to determine which aspects of asset allocation are undertaken by the pool and which by the administering authority, having considered how best to structure decision making in order to deliver value for money. Authorities will need to consider the additional benefits of centralising decision making to better exploit synergies with other participating authorities' allocations and further drive economies of scale. When setting out their asset allocation authorities should be as transparent as possible, for example making clear the underlying asset class sought when using pooled funds.

## **Effective and timely decision making**

3.29 Authorities should draw a distinction between locally setting the strategic asset allocation and centrally determining how that strategy is implemented. The Government expects that implementation of the investment strategy will be delegated to officers or the pool, in order to make the most of the benefits of scale and react efficiently to changing market conditions. As one consultation response suggested:

We believe that high-level decisions about Fund objectives, strategy and allocation are best made by individual Funds considering their better knowledge of their liabilities, risk and return objectives and cash flow requirements. More detailed asset allocation decisions should however be centralised to achieve better economies of scale, and to allow more specialist management.

3.30 Authorities will need to revisit and review their decision-making processes as part of their move towards pools. For example, in order to maximise savings, manager selection will need to be undertaken at the pool level. Centralising manager selection would allow the pool to rationalise the number of managers used for a particular asset class. The resulting larger mandates should then allow the pool to negotiate lower investment fees. This approach would also give local councillors more time to dedicate to the fundamental issue of setting the overarching strategy.

3.31 A number of authorities have already delegated hiring and dismissing managers to a sub-committee comprised predominantly of officers. This has allowed these authorities to

react more quickly to changes in the market, taking advantage of opportunities as they arise. Similarly, delegating implementation decisions to the pool will allow the participating authorities to benefit not only from more streamlined decision making, but also from effecting those decisions at scale.

3.32 The creation of pools will necessarily lead to a review of decision making within each authority. The Government expects to see greater consolidation where possible. However, as a minimum, we would expect to see the selection of external fund managers and the implementation of the investment strategy to be carried out at the pooled level.

### **Responsible investment and effective stewardship**

3.33 In June 2011, the Government invited Professor John Kay to conduct a review into UK equity markets and long-term decision making. The Kay Review considered how well equity markets were achieving their core purposes: to enhance the performance of UK companies and to enable savers to benefit from the activity of these businesses through returns to direct and indirect ownership of shares in UK companies. The review identified that short-termism is a problem in UK equity markets.<sup>8</sup>

3.34 Professor Kay recommended that Company directors, asset managers and asset holders adopt measures to promote both stewardship and long-term decision making. In particular, he stressed that 'asset managers can contribute more to the performance of British business (and in consequence to overall returns to their savers) through greater involvement with the companies in which they invest.'<sup>9</sup> He concludes that adopting such responsible investment practices will prove beneficial for investors and markets alike.

3.35 In practice, responsible investment could involve making investment decisions based on the long term, as well as playing an active role in corporate governance by exercising shareholder voting rights. Administering authorities will want to consider the findings of the Kay Review when developing their proposals, including what governance procedures and mechanisms would be needed to facilitate long term responsible investing and stewardship through a pool. The UK Stewardship Code, published by the Financial Reporting Council, also provides authorities with guidance on good practice in terms of monitoring, and engaging with, the companies in which they invest.

### **Enacting an environmental, social and corporate governance policy**

3.36 The investment regulations currently require authorities to set out within the statement of investment principles the extent to which social, environmental or corporate governance considerations are taken into account in the selection, retention and realisation of investments. The draft regulations published alongside this document do not propose to amend this principle.

3.37 These policies should be developed in the context of the liability profile of the Scheme, and should enhance the authority's ability to manage down any funding deficit and ensure that pensions can be paid when due. Indeed, environmental, social and

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<sup>8</sup> *The Kay Review of UK Equity Markets and Long-Term Decision Making*, pp. 9-10  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf)

<sup>9</sup> The Kay Review, p.12

corporate governance policies provide a useful tool in managing financial risk, as they ensure that the wider risks associated with the viability of an investment are fully recognised.

3.38 As the Law Commission emphasised in its 2014 report on the fiduciary duty of financial intermediaries, the law generally is clear that schemes should consider any factors financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long-term, dependent on the time horizon over which their liabilities arise.

3.39 The Law Commission also clarified that, although schemes should make the pursuit of a financial return their predominant concern, they may take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.

3.40 The Government's intention is to issue guidance to authorities to clarify that such considerations should not result in policies which pursue municipal boycotts, divestments and sanctions, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government. Investment policies should not be used to give effect to municipal foreign or munitions policies that run contrary to Government policy.

3.41 Authorities will need to determine how their individual investment policies will be reflected in the pool. They should also consider how pooling could facilitate implementation of their environmental, social and corporate governance policy, for example by sharing best practice, collaborating on social investments to reduce cost or diversify risk, or using their scale to improve capability in this area.

### **Addressing the criterion**

3.42 When developing their proposals for pooling, authorities will need to set out:

- The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
- The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- Decision making procedures at all stages of investment, and the rationale underpinning this.
- The shared objectives for the pool(s), and any policies that are to be agreed between participants.
- The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
- How any ethical, social and corporate governance policies will be handled by the pool(s).
- How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.

- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

## C. Reduced costs and excellent value for money

**Headline criterion:** In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while maintaining overall investment performance.

Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

3.43 As set out in the July Budget 2015 announcement, the Government wants to see authorities bring forward proposals to reform the way their pension scheme investments are made to deliver long-term savings for local taxpayers. Authorities are invited to consider how they might best deliver value for money, minimising fees while maximising overall investment returns.

### Scope for savings

3.44 Pooling investments offers an opportunity to share knowledge and reduce external investment management fees, as the fund manager is able to treat the authorities as a single client. There is already a considerable body of evidence in the public domain to support authorities in developing their proposals for investment reform and this continues to grow with new initiatives emerging from local authorities:

- **Passive management:** Hymans Robertson showed that annual fee savings of £230m could be found by moving from active to passive management of listed assets like bonds and equities, without affecting the Scheme's overall return.<sup>10</sup>
- Their analysis suggested that since passive management typically results in fewer shares being traded, turnover costs, which are a drag on the performance achieved through active management, might be reduced by £190m a year.<sup>11</sup>
- **Collective investment:** Hymans Robertson also demonstrated that £240m a year could be saved by using a collective investment vehicle instead of "fund of funds" for illiquid assets like infrastructure, hedge funds and private equity.<sup>12</sup>
- Similarly, the London Pension Fund Authority has estimated that they have reduced their external manager fees by 75% by bringing equity investments in-house, and hope to expand this considerably as part of their collective investment vehicle with Lancashire County Pension Fund.<sup>13</sup>

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<sup>10</sup> Hymans Robertson report, p. 12

<sup>11</sup> Hymans Robertson report, pp. 14-15

<sup>12</sup> Hymans Robertson report, p. 3

<sup>13</sup> Chris Rule, LPFA Chief Investment Officer, reported in *Pension Expert* on 1 October 2015

- **Sharing services and procurement costs:** The National Procurement Framework has also helped authorities to address some of the other costs associated with investment, such as legal and custodian fees, reporting measurable savings of £16m so far.<sup>14</sup>

3.45 As Hymans Robertson's analysis shows, just tackling the use of "fund of funds" for illiquid assets like infrastructure could save around £240m a year, with clear opportunities to go further. It is in this context that the Government is encouraging authorities to bring forward their proposals for collaboration and cost savings. Although a particular savings target has not been set, the Government does expect authorities to be ambitious in their pursuit of economies of scale and value for money.

### **In-house management**

3.46 Some authorities manage all or the majority of their assets internally and so can already show very low management costs. In these cases, a move to a collective investment vehicle with external fund managers is unlikely to deliver cost savings from investment fees alone. However, there are wider benefits of collaboration which authorities with in-house teams should consider when developing their proposals for pooling. A pool of internally managed assets could lead to further reductions in costs, for example by sharing staff, research and due diligence checks; it may improve access to staff with stronger expertise in particular asset classes; and could introduce greater resilience in staff recruitment, retention and succession planning. Alternatively, newly created pools might wish to work with existing in-house teams to build up expertise and take advantage of their lower running costs.

### **Active and passive management**

3.47 The May 2014 consultation considered the use of active and passive management by the Local Government Pension Scheme. Active management attempts to select fund managers who actively choose a portfolio of assets in order to deliver a return against a specific investment target. In practice, this is often used to try and outperform a benchmark, for that class of assets over a specific period. In contrast, passive management tracks a market and aims to deliver a return in line with that market.

3.48 The consultation demonstrated that when considered in aggregate, the Scheme had been achieving a market return over the last ten years in each of the main equity markets. This suggested that collectively the Scheme could have delivered savings by using less costly passive management for listed assets like bonds and equities, without affecting overall performance. While the majority of consultation responses agreed that there was a role for passive management in a balanced portfolio, most also argued that authorities should retain the use of active management where they felt it would deliver higher net returns.

3.49 In response to that consultation, the Government has now invited authorities to bring forward proposals for pooling investments to deliver economies of scale. The extent to which passive management is used will remain a decision for each authority or pool,

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<sup>14</sup> National LGPS Frameworks website, <http://www.nationallgpsframeworks.org/national-lgps-frameworks-win-lgc-investment-award>

based on their investment strategy, ongoing performance and ability to negotiate lower fees with fund managers. However, in light of the evidence set out in the Hymans Robertson report and the May 2014 consultation, authorities are encouraged to keep their balance of active and passive management under review to ensure they are delivering value for money. For example, should their net returns compare poorly against the index in a particular asset class over the longer term, authorities should consider whether they are still securing value for money for taxpayers and Scheme members.

3.50 When determining how to measure performance, authorities are encouraged to consider setting targets for active managers that are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

### **Improving the transparency of costs**

3.51 In addition to the fees paid to asset managers, there are considerable hidden costs of investment that are difficult to identify and so often go unreported by investors. In the case of the Local Government Pension Scheme, Hymans Robertson showed that investment costs in 2012-13 were at least £790m a year, in contrast to the £409m reported by the authorities.<sup>15</sup> Even the £790m understated the total investment costs as it excluded performance fees on alternative assets such as private equity and hedge funds (it included performance fees on traditional assets) and turnover costs (investment performance figures include the impact of turnover costs).

3.52 To really drive savings within the Scheme, it is essential that these hidden costs are better understood and reported as transparently as possible. Although many of these costs are not paid out in cash, they do erode the value of the assets available for investment and so should also be scrutinised and the opportunities for savings explored.

3.53 The Chartered Institute of Public Finance and Accountancy (CIPFA) has already made some changes to their guidance, Accounting for Local Government Pension Scheme management costs 2014, to encourage authorities to explore these costs and report some through a note to the accounts. For example, these include performance fees and management fees on pools deducted at source. Authorities should have regard to this guidance and ensure that they are reporting costs as transparently as possible.

3.54 In addition, the Scheme Advisory Board is commissioning advice to help authorities more accurately assess their transparent and hidden investment costs. Once available, authorities should take full advantage of this analysis when developing their proposals.

### **Addressing the criterion**

3.55 As set out above, there is a clear opportunity for authorities to collaborate to deliver hundreds of millions in savings in the medium term. Although there is no overall savings target for the Scheme, the Government expects authorities to take full advantage of the benefits of pooling to reduce costs while maintaining performance.

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<sup>15</sup> Hymans Robertson report, pp.10-11



3.56 To support the delivery of savings authorities bringing forward proposals are asked to set out their current investment costs in detail, and demonstrate how these will be reduced over time and the savings forecast. Where possible, costs should be reported back to 2012-2013 so that any cost reductions already achieved as a result of procurement frameworks and early fee negotiations are transparently captured.

3.57 Authorities are encouraged to provide:

- A fully transparent assessment of investment costs and fees as at 31 March 2013.
- A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- A detailed estimate of savings over the next 15 years.
- A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
- A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

## D. An improved capacity and capability to invest in infrastructure

**Headline criterion:** Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class.

3.58 Investment in infrastructure is increasingly being seen as a suitable option for pension funds, particularly amongst larger organisations. This may in part be the result of the typically long term nature of these investments, which may offer a useful match to the long term liabilities held by pension funds.

### International experience

3.59 Multiple large international pension funds are investing a significant proportion of their assets in infrastructure. A recent OECD report, which analysed a sample of global pension funds as at 2012, showed that some Canadian and Australian funds (with total assets of approximately £35-40bn in 2014 terms) were investing up to 10-15% in this asset class.<sup>16</sup> The report also noted that those funds with the largest infrastructure allocations were investing directly, and that such investment was the result of the build up of sector-specific knowledge, expertise and resources.<sup>17</sup> This experience might be demonstrated through an organisation's ability to manage large projects, as well as the associated risk.

3.60 Figures published by the Scheme Advisory Board for the 2013 Annual Report show that around £550m, or 0.3%, of the Scheme's total assets of £180bn was invested in infrastructure.<sup>18</sup> This falls some way behind other large pension funds that have elected to invest in this area, such as those noted above and the Ontario Teachers Pension Plan which invested 6.1% according to the same 2014 report.

### Creating the opportunity

3.61 The Scheme's current structure, where assets are locked into 90 separate funds, reduces scale and makes significant direct infrastructure investment more difficult for administering authorities. As a result, authorities may determine that they are unable to invest in infrastructure, or may invest indirectly, through the "fund of funds" structure. Such arrangements are expensive, as the Hymans Robertson report demonstrated and this paper sets out in paragraph 3.13.

3.62 Developing larger investment pools of at least £25bn will make it easier to develop or acquire improved capacity and capability to invest in infrastructure. In so doing, it should be possible to reduce the costs associated with investment in this area. This is likely to be the case particularly if authorities pool their infrastructure investment nationally, where the

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<sup>16</sup> OECD, *Annual Survey of Large Pension Funds: report on pension funds' long-term investments*, p.32, available at: <http://www.oecd.org/daf/fin/private-pensions/LargestPensionFunds2012Survey.pdf>

<sup>17</sup> OECD report, p.14

<sup>18</sup> Scheme Advisory Board annual report <http://www.lgpsboard.org/index.php/scheme-investments>

resultant scale may allow them to buy-in or build-up in-house expertise in relevant areas, such as project and risk management.

3.63 In considering such investment, administering authorities might want to reflect on the wide range of assets that might be explored, such as railway, road or other transport facilities; utilities services like water and gas infrastructure; health, educational, court or prison facilities, and housing supply. Authorities should also examine the benefits of both:

- Greenfield infrastructure – projects involving the construction of brand new infrastructure, such as a new road or motorway junction to unlock a housing development, or the recent investment of £25m by the Greater Manchester Pension Fund to unlock new sites and build 240 houses; and
- Brownfield infrastructure – investing in pre-existing infrastructure projects, such as taking over the running of (or the construction of a new terminal building at) an airport.

3.64 As set out above, investment in infrastructure represents a viable investment for pension funds, offering long term returns to match their liabilities. Authorities will need to make their investments based on an assessment of risk, return and fit with investment strategy. However, the creation of large pools will make greater investment in infrastructure a more realistic prospect, opening up new opportunities to develop or buy-in the capacity and capability required.

3.65 In developing their proposals for pooling, authorities should take the opportunity to review their asset allocation decisions and consider how they can be more ambitious in their infrastructure investment. The Government believes that authorities can play a leading role in UK infrastructure and driving local growth, and encourages authorities to compare themselves against the example set by the leading global pension fund investors in their approach to allocating assets in this area.

### **Addressing the criterion**

3.66 Authorities should identify their current allocation to infrastructure, and consider how the creation of up to six pools might facilitate greater investment in this area. When developing proposals, authorities should explain:

- The proportion of their fund currently allocated to infrastructure, both directly and through fund, or “fund of funds”.
- How they might develop or acquire the capability and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or “fund of funds” arrangements.
- The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

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Department for  
Communities and  
Local Government

# Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

Consultation



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# About this consultation

This consultation document and consultation process have been planned to adhere to the Consultation Principles issued by the Cabinet Office.

Representative groups are asked to give a summary of the people and organisations they represent, and where relevant who else they have consulted in reaching their conclusions when they respond.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department for Communities and Local Government will process your personal data in accordance with DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Individual responses will not be acknowledged unless specifically requested.

Your opinions are valuable to us. Thank you for taking the time to read this document and respond.

Are you satisfied that this consultation has followed the Consultation Principles? If not or you have any other observations about how we can improve the process please contact DCLG Consultation Co-ordinator.

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# The consultation process and how to respond

## Scope of the consultation

<p><b>Topic of this consultation:</b></p>	<p>This consultation proposes to revoke and replace the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 with the draft regulations described in this paper. There are two main areas of reform:</p> <ol style="list-style-type: none"> <li>1. A package of reforms that propose to remove some of the existing prescribed means of securing a diversified investment strategy and instead place the onus on authorities to determine the balance of their investments and take account of risk.</li> <li>2. The introduction of safeguards to ensure that the more flexible legislation proposed is used appropriately and that the guidance on pooling assets is adhered to. This includes a suggested power to allow the Secretary of State to intervene in the investment function of an administering authority when necessary.</li> </ol>
<p><b>Scope of this consultation:</b></p>	<p>Views are sought on:</p> <ol style="list-style-type: none"> <li>1. Whether the proposed revisions to the investment regulations will give authorities the flexibility to determine a suitable investment strategy that appropriately takes account of risk.</li> <li>2. Whether the proposals to introduce the power of intervention as a safeguard will enable the Secretary of State to intervene, when appropriate, to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.</li> </ol>
<p><b>Geographical scope:</b></p>	<p>This consultation applies to England and Wales.</p>
<p><b>Impact Assessment:</b></p>	<p>The proposed interventions affect the investment of assets by local government pension scheme administering authorities. These authorities are all public sector organisations, so no impact assessment is required.</p>

## Basic Information

<b>To:</b>	The consultation is aimed at all parties with an interest in the Local Government Pension Scheme (the Scheme) and in particular those listed on the Government's website: <a href="https://www.gov.uk/government/publications/local-government-pension-scheme-regulations-information-on-who-should-be-consulted">https://www.gov.uk/government/publications/local-government-pension-scheme-regulations-information-on-who-should-be-consulted</a>
<b>Body/bodies responsible for the consultation:</b>	Secretary of State, Department for Communities and Local Government.  The consultation will be administered by the Workforce, Pay and Pensions Division.
<b>Duration:</b>	25 November 2015 to 19 February 2016
<b>Enquiries:</b>	Enquires should be sent to Victoria Edwards. Please email <a href="mailto:LGPSReform@communities.gsi.gov.uk">LGPSReform@communities.gsi.gov.uk</a> or call 0303 444 4057.
<b>How to respond:</b>	Responses to this consultation should be submitted to <a href="mailto:LGPSReform@communities.gsi.gov.uk">LGPSReform@communities.gsi.gov.uk</a> by <b>19 February 2016</b> .  Electronic responses are preferred. However, you can also write to:  LGPS Reform Department for Communities and Local Government 2/SE Quarter, Fry Building 2 Marsham Street London SW1P 4DF
<b>Additional ways to become involved:</b>	If you would like to discuss the proposals, please email <a href="mailto:LGPSReform@communities.gsi.gov.uk">LGPSReform@communities.gsi.gov.uk</a>
<b>After the consultation:</b>	All consultation responses will be reviewed and analysed. A Government response will then be published within three months, and subject to the outcome of this consultation, the resulting regulations laid in Parliament.
<b>Compatibility with the Consultation Principles:</b>	This consultation has been drafted in accordance with the Consultation Principles.

## Background

<b>Getting to this stage:</b>	<p>The proposals in this consultation are the culmination of work looking into Local Government Pension Scheme investments that began in early 2013. It has been developed in response to the May 2014 consultation, <i>Opportunities for collaboration, cost savings and efficiencies</i>, which considered whether savings might be delivered through collective investment and greater use of passive fund management. A copy of the consultation and the Government's response is available on the Government's website: <a href="https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies">https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies</a>.</p> <p>The consultation responses called for a voluntary approach to reform, opposing the introduction of a single, national model of pooling. The Government has therefore invited authorities to develop their own proposals for pooling, subject to common criteria and guidance. The criteria for reform have been developed using the consultation responses and following a series of workshops and conversations with authorities and the fund management industry since the July Budget 2015.</p> <p>Some respondents to the May 2014 consultation also suggested that amendments were required to the investment regulations in order to facilitate greater investment in pooled vehicles. In addition, prior to that consultation, authorities and the fund management industry had called for wider reform. A small working group, whose participants are listed in Annex A, was established to look at whether the approach to risk management and diversification in the existing regulations was still appropriate. They recommended moving towards the "prudential person" approach that governs trust based pension schemes. The group also sought clarity as to whether certain types of investment were possible, such as the use of derivatives in risk management. The work of that group has informed the development of this consultation.</p> <p>In relaxing the regulatory framework for scheme investments, it is important to introduce safeguards to ensure that the less prescriptive approach is used appropriately. The July Budget 2015 announcement also indicated that measures should be introduced to ensure that those authorities who do not bring forward ambitious proposals for pooling, in keeping with the criteria, should be required to pool. This consultation therefore sets out how the Secretary of State might intervene to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.</p>
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<p><b>Previous engagement:</b></p>	<p>The proposed changes in this consultation are the result of a programme of engagement that began in summer 2013:</p> <ul style="list-style-type: none"> <li>• Round table event, 16 May 2013. Representatives of administering authorities, employers, trade unions, the actuarial profession and academia discussed the potential for increased cooperation within the Scheme.</li> <li>• A call for evidence, run with the Local Government Association, June to September 2013. This gave anyone with an interest in the Scheme the opportunity to inform the Government's thinking on potential structural reform. The results were shared with the Shadow Scheme Advisory Board, which provided the Minister for Local Government with their analysis of the responses.</li> <li>• Consultation, <i>Opportunities for collaboration, cost savings and efficiencies</i>, May to June 2014. The consultation set out how savings of £470-660m a year could be achieved by collective investment and greater use of passive fund management. It also sought views as to how these reforms might best be implemented. The Government's response is available online:  <a href="https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies">https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies</a>.</li> <li>• Informal engagement, July to November, 2015. Since the July Budget 2015 announcement, officials have attended over 25 workshops and bi-lateral meetings with administering authorities and the fund management industry. These discussions have been used to develop the criteria for reform and inform how the proposed power of the Secretary of State to intervene might work.</li> </ul> <p>In addition, the Investment Regulation Review Group was formed in 2012 to consider potential amendments to the investment regulations. The group included representatives from administering authorities, actuarial firms, pension lawyers and the fund management industry. An initial proposal for reform was prepared that has also informed the development of the draft regulations that are the subject of this consultation.</p>
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# Introduction and Background

## Introduction

1.1 In May 2014 the Government published a consultation which set out how savings of up to £660m a year might be achieved through greater use of passive management and pooled investment. Investing collectively can help authorities to drive down costs and access the benefits of scale, and also enables them to develop the capacity and capability to invest more cost effectively in illiquid asset classes such as infrastructure. The Government has therefore invited authorities to develop ambitious proposals for pooling assets that meet published criteria. More information about the criteria and process of reform is available on the Government's website:

<https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>.

1.2 This consultation complements that invitation, recognising that the existing regulations place restrictions on certain investments that may constrain authorities considering how best to pool their assets. It therefore proposes to move to a prudential approach to securing a diversified investment strategy that appropriately takes account of risk. In so doing, and to ensure that authorities take advantage of the benefits of scale, the Government proposes to introduce a power to allow the Secretary of State to intervene to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.

1.3 This paper sets out the purpose and rationale of the suggested amendments to the investment regulations, and seeks views as to whether the proposed approach would best deliver those stated aims.

## Background

1.4 With assets of £178bn at its last valuation on 31 March 2013, the Local Government Pension Scheme is one of the largest funded pension schemes in Europe. Several thousand employers participate in the Scheme, which has a total of 4.68 million active, deferred and pensioner members.<sup>1</sup> The Department for Communities and Local Government is responsible for the regulatory framework governing the Scheme in England and Wales.

1.5 The Scheme is managed through 90 administering authorities which broadly correspond to the county councils following the 1974 local government reorganisation as well as each of the 33 London boroughs. In most cases, the administering authorities are upper tier local authorities such as county or unitary councils, but there are also some authorities established specifically to manage their pension liabilities, for example the London Pension Fund Authority and the Environment Agency Pension Fund. The

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<sup>1</sup> Scheme asset value and membership figures taken from Department for Communities and Local Government statistical data set - Local government pension scheme funds summary data: 2012 to 2013 <https://www.gov.uk/government/statistical-data-sets/local-government-pension-scheme-funds-summary-data-2012-to-2013>

administering authorities have individual governance and working arrangements. Each has its own funding level, cash-flow and balance of active, deferred and pensioner members. Authorities take these circumstances into account when preparing their investment strategies, which are normally agreed by the councillors on each authority's pension committee. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 set the legal framework for the development of these investment strategies and the investments carried out by administering authorities. This consultation proposes that the Government revokes and replaces those regulations.

1.6 Under the Public Service Pensions Act 2013, there is a requirement for a national scheme advisory board, as well as a local board for each of the 90 funds. In 2013, Scheme employers and the trade unions established a shadow board, which has been considering a number of issues connected with the Scheme, including its efficient management and administration. Appointments have now been made to the national scheme advisory board and the Chair is expected to be appointed shortly.

# Getting to this stage

2.1 The consultation is formed of two main proposals:

1. A package of reforms that propose to remove some the existing prescribed means of securing a diversified investment strategy and instead place the onus on authorities to determine the balance of their investments and take account of risk. The changes proposed would move towards the “prudent person” approach to investment that applies to trust based pension schemes.
2. The introduction of safeguards to ensure that the more flexible legislation proposed is used appropriately, and that the guidance on pooling assets is adhered to, including a power to allow the Secretary of State to intervene in the investment function of an administering authority when necessary.

## Pooling assets to deliver the benefits of scale

2.2 The proposals set out in this consultation are the culmination of work carried out over the last two and a half years to explore how to reform the way the Scheme makes its investments in order to achieve the benefits of scale and drive efficiencies.

2.3 In summer 2013, the coalition government launched a call for evidence to explore how the Scheme might be made more sustainable and affordable in the long term. 133 responses were received, many of which took the opportunity to discuss whether collective investment and greater collaboration might deliver savings for the Scheme.

2.4 Following the call for evidence, the Minister for the Cabinet Office and Minister for Local Government commissioned a cost-benefits analysis from Hymans Robertson on a range of proposals. Hymans Robertson’s report explored three areas:

- **The cost of investment:** Many of the costs associated with investment are not transparent and so difficult to capture. The costs of managing and administering the Scheme were reported as being £536 million in 2012-13.<sup>2</sup> However, Hymans Robertson found that the actual cost was likely to be rather higher; with investment costs alone estimated as in excess of £790 million a year.<sup>3</sup>
- **Approaches to collaboration:** Hymans Robertson was asked to examine the costs and benefits of three options for reform: merging the authorities into 5-10 funds, creating 5-10 collective investment vehicles, or establishing just 1-2 collective investment vehicles. They found that the net present value of savings over ten years was highest with a small number of vehicles, while merging funds offered the lowest benefit.<sup>4</sup>

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<sup>2</sup> Local government pension scheme funds summary data: 2012 to 2013

<sup>3</sup> Department for Communities and Local Government: Local Government Pension Scheme structure analysis, Hymans Robertson pp. 10-11. <https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>

<sup>4</sup> Hymans Robertson, p.6

- **The aggregate performance of the scheme:** The report found that the Scheme as a whole had been achieving the market rate of return in each of the main equity markets over the ten years to March 2013. If the Scheme's investments in bonds and equities had been managed passively instead of actively, authorities could have saved at least £230m a year in management fees without affecting overall investment returns.<sup>5</sup>

2.5 Drawing on the Hymans Robertson report and the call for evidence, the coalition government published a consultation in May 2014 entitled *Opportunities for collaboration, cost savings and efficiencies*. This set out how the Scheme could save up to £660m a year by using collective investment vehicles and making greater use of passive management for listed assets like bonds and equities. The consultation sought views on these proposals, and how they might be most effectively implemented. Respondents were broadly in favour of pooling assets, but felt that any reform should be voluntary and led by administering authorities. While many recognised a role for passive management in an investment strategy, most also felt that some active management should be retained.

2.6 At the July Budget 2015, Ministers having reflected on the consultation responses, the Chancellor announced the Government's intention to invite administering authorities to bring forward proposals for pooling local government pension scheme investments. Authorities' proposals would be assessed against published criteria, designed to encourage ambition in the pursuit of efficiencies and the benefits of scale. These criteria have now been published and are available online at <https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>.

## Updating the investment regulations

2.7 When considering the implications of creating asset pools amongst authorities, some respondents to the May 2014 consultation took the opportunity to call for a review of the existing investment regulations. At their introduction in 2009, the regulations sought to ensure that authorities established a balanced and diversified portfolio by placing restrictions on the proportion of their assets that could be invested in different vehicles. For example, deposits with a single bank, institution or person, (other than the National Savings Bank), were restricted to 10% of an authority's assets. These restrictions have been kept under regular review and have been subject to change following representations from the investment sector and pension fund authorities.

2.8 Some respondents to the consultation suggested that the current limits on investments would prevent authorities from making meaningful allocations to a collective investment vehicle, one of the leading options for asset pooling, as the allocation to particular types of vehicle is capped at 35%. Participants in the London Boroughs' collective investment vehicle and the collaboration between the London Pension Fund Authority and Lancashire County Council also wrote to the Department encouraging reform in this area.

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<sup>5</sup> Hymans Robertson, p.12



2.9 While the proposals for collective investment in the May 2014 consultation prompted encouragement to review the investment regulations, the idea of reform was not new. In 2012, following representations from the investment sector, the Government formed a small working group to revisit and examine the investment regulations with input from actuaries, fund managers and administering authorities. This group, whose membership is set out in Annex A, recommended that a more permissive approach should be taken to the legislative framework, similar to the “prudent person” model that applies to trust based pension schemes. This approach places the onus on the pension fund to determine a suitable balance of investments to meet its liabilities, which are clearly articulated in an investment strategy. The group also felt that the existing regulations introduced uncertainty for some authorities as to what constituted a permitted investment, as some asset classes were explicitly referenced but others were not. In particular, concern has been expressed as to whether or not pension fund authorities are permitted to invest in vehicles such as derivatives, hedge funds and forward currency contracts.

2.10 The proposals in this consultation paper therefore seek to address these issues, placing the onus on authorities to determine a diversified investment strategy that appropriately takes risk into account.

2.11 However, in relaxing the regulatory framework for scheme investments, it is also important to introduce safeguards to ensure that the less prescriptive approach proposed is used appropriately. Similarly, the July Budget 2015 announcement stated that draft regulations would be introduced to require an authority to pool its investments if it did not bring forward ambitious proposals that met the Government’s criteria. This consultation therefore sets out how the Secretary of State might intervene to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.

## Response to the Law Commission’s Review of Fiduciary Duty

2.12 The Kay Review on Fiduciary Duty published its final report in July 2012. In addition to making a number of recommendations to address the excessive focus on short-term performance in equity investment markets, it recommended that the Government ask the Law Commission to review the fiduciary duties of investment intermediaries amid concerns that these common law duties were being interpreted by some pension schemes as a requirement to focus solely on short-term financial returns.

2.13 In their report, published in July 2014, the Law Commission called on the Department to review:

- Whether the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 should transpose article 18(1) of the Institutions for Occupational Retirement Provision (IORP) Directive, and
- Those aspects of Regulation 9 of the 2009 Regulations which require investment managers to be appointed on a short-term basis and reviewed every three months.

2.14 These recommendations were supported by the Government's progress report on the implementation of the Kay Review published in October 2014 by the Department for Business Innovation and Skills.

2.15 Article 18(1) of the IORP Directive requires assets to be invested in the best interests of members and beneficiaries and, in the event of a conflict of interest, in the sole interests of members and beneficiaries.

2.16 Regulation 4 of The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005 No 3378) transposed Article 18(1):

"4. (1) The trustees of a trust scheme must exercise their powers of investment, and any fund manager to whom any discretion has been delegated under section 34 of the 1995 Act (power of investment and delegation) must exercise the discretion, in accordance with the following provisions of this regulation

(2) The assets must be invested:

- (a) In the best interests of members and beneficiaries; and
- (b) In the case of a potential conflict of interest, in the sole interest of members and beneficiaries."

2.17 The Local Government Pension Scheme is a statutory scheme made under section 1 of the Public Service Pensions Act 2013 and previously under The Superannuation Act 1972. It is not subject to trust law and those responsible for making investment decisions in the Scheme are not therefore required to comply with Regulation 4 of the 2005 Regulations.

2.18 However, this does nothing to change the general legal principles governing the administration of Scheme investments and how those responsible for such decisions should exercise their duties and powers under the Scheme's investment regulations.

2.19 In a circular issued by the then Department of the Environment in 1983 (No 24), the Secretary of State took the view that administering authorities should pay due regard to the principle contained in the case of *Roberts v Hopwood* [1925] A.C. 578 p. 595:

"A body charged with the administration for definite purposes of funds contributed in whole or in part by persons other than members of that body owes, in my view, a duty to those latter persons to conduct that administration in a fairly business-like manner with reasonable care, skill and caution, and with a due and alert regard to the interest of those contributors who are not members of the body. Towards these latter persons, the body stands somewhat in the position of trustees or managers of the property of others."

2.20 Those in local government responsible for making investment decisions must also act in accordance with ordinary public law principles, in particular, the ordinary public law principles of reasonableness. They risk challenge if a decision they make is so unreasonable that no reasonable person acting reasonably could have made it.

2.21 Having considered fully the recommendation made by the Kay Review and supported by both the Law Commission and the Government, Ministers are satisfied that the Scheme is consistent with the national legislative framework governing the duties placed on those responsible for making investment decisions. The position at common law

is also indistinguishable from that produced by the 2005 Regulations applicable in respect of trust-based schemes.

2.22 We do, however, propose to remove the requirement for the performance of investment managers to be reviewed once every three months from the regulations.

# Proposal 1: Adopting a local approach to investment

## Deregulating and adopting a local approach to investment

3.1 In developing these draft regulations, the Government has sought, where appropriate, to deregulate and simplify the regulations that have governed the management and investment of funds since 2009. Some of the existing provisions have not been carried forward into the draft 2016 Regulations in the expectation that they would be effectively maintained by general law provisions and so specific regulation is no longer needed. For example, those making investment decisions are still required to act prudently, and there remains a statutory requirement to take and act on proper advice. Some of the provisions in the 2009 Regulations which have not been carried forward on this basis include:

- Stock lending arrangements under Regulation 3(8) and (9) of the 2009 regulations. The view is taken that the definition of “investment” in draft Regulation 3 is sufficient given that a stock lending arrangement can only be used if it falls within the ordinary meaning of an “investment”.
- Regulation 8(5) of the 2009 regulations ensures that funds are managed by an adequate number of investment managers and that, where there is more than one investment manager, the value of the fund money managed by them is not disproportionate. Here, the view is taken that administering authorities should be responsible for managing their own affairs and making decisions of this kind based on prudent and proper advice.
- There are many provisions in the 2009 Regulations which impose conditions on the choice and terms of appointments of investment managers. Since the activities of investment managers are governed by the contracts under which they are appointed, the view is taken that making similar provision in the 2016 Regulations would be unnecessary duplication. Examples include the requirement for investment managers to comply with an administering authority’s instructions and the power to terminate the appointment by not more than one month’s notice.
- Regulation 12(3) of the 2009 Regulations requires administering authorities to state the extent to which they comply with guidance given by the Secretary of State on the Myners principles for investment decision making. As part of the wider deregulation, the draft regulations make no provision to report against these principles, although authorities should still have regard to the guidance.

3.2 These examples of deregulation are for illustrative purposes only. It is not an exhaustive list of provisions which the Government proposes to remove. Consultees are asked to look carefully at the full extent of deregulation and comment on any particular case that raises concerns about the impact such an omission might have on the effective management and investment of funds.

## Investment strategy statement

3.3 As part of this deregulation, the draft regulations also propose to remove the existing schedule of limitations on investments. Instead authorities will be expected to take a prudential approach, demonstrating that they have given consideration to the suitability of different types of investment, have ensured an appropriately diverse portfolio of assets and have ensured an appropriate approach to managing risk.

3.4 Key to this will be the investment strategy statement, which authorities will be required to prepare, having taken proper advice, and publish. The statement must cover:

- A requirement to use a wide variety of investments.
- The authority's assessment of the suitability of particular investments and types of investments.
- The authority's approach to risk, including how it will be measured and managed.
- The authority's approach to collaborative investment, including the use of collective investment vehicles and shared services.
- The authority's environmental, social and corporate governance policy.
- The authority's policy on the exercise of rights, including voting rights, attached to its investments.

### Transitional arrangements

3.5 Draft regulation seven proposes to require authorities to publish an investment strategy statement no later than six months after the regulations come into force (this is currently drafted as 1 October 2016, in case the draft regulations come into effect on 1 April 2016). However, the draft regulations would also revoke the existing 2009 Regulations when they come into effect. Transitional arrangements are therefore required to ensure that an authority's investments and investment strategy are regulated between the draft regulations coming into effect and the publication of an authority's new investment strategy statement. The transitional arrangements proposed in draft regulation 12 would mean that the following regulations in the 2009 Regulations would remain in place until the authority publishes an investment strategy or six months lapses from the date that the regulations come into effect:

- 11 (investment policy and investment of pension fund money)
- 14 (restrictions on investments)
- 15 (requirements for increased limits)
- Schedule 1 (table of limits on investments)

### Statement of Investment Principles

3.6 We do not propose to carry forward the existing requirement under regulation 12 of the 2009 Regulations to maintain a Statement of Investment Principles. However, the main elements, such as risk, diversification, corporate governance and suitability, will instead be carried forward as part of the reporting requirements of the new investment strategy

statement. Administering authorities will still be required to maintain their funding strategy statements under Regulation 58 of the 2013 regulations.

## Non-financial factors

3.7 The Secretary of State has made clear that using pensions and procurement policies to pursue boycotts, divestments and sanctions against foreign nations and the UK defence industry are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government. The Secretary of State has said, “Divisive policies undermine good community relations, and harm the economic security of families by pushing up council tax. We need to challenge and prevent the politics of division.”

3.8 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 already require administering authorities to publish and follow a statement of investment principles, which must comply with guidance issued by the Secretary of State. The draft replacement Regulations include provision for administering authorities to publish their policies on the extent to which environmental, social and corporate governance matters are taken into account in the selection, retention and realisation of investments. Guidance on how these policies should reflect foreign policy and related issues will be published ahead of the new Regulations coming into force. This will make clear to authorities that in formulating these policies their predominant concern should be the pursuit of a financial return on their investments, including over the longer term, and that, reflecting the position set out in the paragraph above, they should not pursue policies which run contrary to UK foreign policy.

## Investment

3.9 A few definitions and some aspects of regulation 3, which describes what constitutes an investment for the purpose of these regulations, have been updated to take account of changing terminology and technical changes since the regulations were last issued in 2009. For example, the reference to the London International Financial Futures Exchange (LIFFE) has been removed as it now operates as a clearing house and so is covered by the approved stock exchange definition.

3.10 Some additional information has been included to make clear that certain investments, such as derivatives, may be used where appropriate. The Government expects that having considered the appropriateness of an investment in their investment strategy statement, authorities would only use derivatives as a means of managing risk, and so has not explicitly stated that this should be the case.

## Questions

1. Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?
2. Are there any specific issues that should be reinstated? Please explain why.

3. Is six months the appropriate period for the transitional arrangements to remain in place?
4. Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?

# Proposal 2: Introducing a safeguard - Secretary of State power of intervention

## Summary of the proposal

4.1 The first part of this consultation lifts some of the existing restrictions on administering authorities' investments in order to make it easier for them to pool their investments and access the benefits of scale. To ensure that this new flexibility is used appropriately, the consultation also proposes to introduce a power to intervene in the investment function of an administering authority if the Secretary of State believes that it has not had regard to guidance and regulations. The consultation sets out the evidence that the Secretary of State may draw on before deciding to intervene, and makes clear that any direction will need to be proportionate. The power proposed in this consultation is intended to allow the Secretary of State to act if best practice or regulation is being ignored, which will help to ensure that authorities continue to pursue more efficient means of investment.

4.2 The July Budget 2015 announcement set out the Government's intention to introduce "backstop" legislation to require those authorities who do not bring forward sufficiently ambitious plans to pool their investments. It also explained that authorities' proposals would need to meet common criteria, which have been published with draft guidance alongside this consultation. The draft power to intervene discussed in this paper could be used to address authorities that do not bring forward proposals for pooling their assets in line with the published criteria and guidance. The guidance will be kept under review, and will be revised as circumstances change and authorities' asset pools evolve.

4.3 The following sections set out the process for intervention described in draft regulation 8.

## Determining to intervene

4.4 The draft regulations propose to give the Secretary of State the power to intervene in the investment function an administering authority, if the Secretary of State has determined that the administering authority has failed to have regard to the regulations governing their investments or guidance issued under draft regulation 7(1). In reaching that conclusion, the Secretary of State will consider the available evidence, which might include:

- Evidence that an administering authority is ignoring information on best practice, for example, by not responding to advice provided by the scheme advisory board to local pension boards.
- Evidence that an administering authority is not following the investment regulations or has not had regard to guidance published by the Secretary of State under draft Regulation 7 (1). For example, this might include failing to participate in one of the large asset pools described in the existing draft guidance, or proposing a pooling arrangement that does not adhere to the criteria and guidance.



- Evidence that an administering authority is carrying out another pension-related function poorly, such as an unsatisfactory report under section 13(4) of the Public Service Pensions Act 2013, or another periodic reporting mechanism. (Section 13(4) of the 2013 Act requires a person appointed by the Secretary of State to report on whether the actuarial valuation of a fund has been carried out in accordance with Scheme regulations, in a way that is consistent with other authorities' valuations, and so that employer contribution rates are set to ensure the solvency and long term cost efficiency of the fund.)

4.5 If the Secretary of State has some indication to suggest that intervention might be necessary, the draft regulations propose that he may order a further investigation to provide him with the analysis required to make a decision. If additional evidence is sought, draft regulation 8(5) would allow the Secretary of State to carry out such inquiries as he considers appropriate, including seeking advice from external experts if needed. In this circumstance, the administering authority would be obliged to provide any data that was deemed necessary to determine whether intervention is required. The authority would also be invited to participate in the review and would have the opportunity to present evidence in support of its existing or proposed investment strategy.

## The process of intervention

4.6 If the Secretary of State is satisfied that an intervention is required, he would then need to determine the appropriate extent of intervention in the authority's investment function. The draft regulations propose to allow the Secretary of State to draw on external advice to determine what the specific intervention should be if necessary.

4.7 Draft regulation 8(2) describes the interventions that the Secretary of State may make. The power has been left intentionally broad to ensure that a tailored and measured course of action is applied, based on the circumstances of each case. For example, in some cases it may be appropriate to apply the intervention just to certain parts of an investment strategy, whereas in particularly concerning cases, more substantial action might be required. The proposed intervention might include, but is not limited to:

- Requiring an administering authority to develop a new investment strategy statement that follows guidance published under draft Regulation 7(1).
- Directing an administering authority to invest all or a portion of its assets in a particular way that more closely adheres to the criteria and guidance, for instance through a pooled vehicle.
- Requiring that the investment functions of the administering authority are exercised by the Secretary of State or his nominee.
- Directing the implementation of the investment strategy of the administering authority to be undertaken by another body.

4.8 The Secretary of State will write to the authority outlining the proposed intervention. As a minimum, this proposal will include:

- A detailed explanation of why the Secretary of State is intervening and the evidence used to arrive at their determination.

- A clear description of the proposed intervention and how it will be implemented and monitored.
- The timetable for the intervention, including the period of time until the intervention is formally reviewed.
- The circumstances under which the intervention might be lifted prior to review.

4.9 The authority will then be given time to consider the proposal and present its argument for any changes that it thinks should be made. If, at the end of that period an intervention is issued, any resulting costs, charges and expenses incurred in administering the fund would be met by the pension fund assets.

## Review

4.10 As set out above, each intervention will be subject to a formal review period which will be set by the Secretary of State but may coincide with other cyclical events such as the preparation of an annual report or a triennial valuation. At the end of that period, progress will be assessed and the Secretary of State will decide whether to end, modify or maintain the current terms of the intervention, and will notify the authority of the outcome. The authority will also have the opportunity to make representations to the Secretary of State if it feels a different course of action should be followed. Throughout this period of intervention, the authority will be supported to improve its investment function, so that it is well placed to bring the intervention to an end at the first opportunity.

4.11 The Secretary of State's direction will include details about what is required of the authority in order to end the intervention, and how progress will be measured. Progress could, for example, be measured by creating a set of performance indicators to be monitored on an ongoing basis by Government officials, the local pension board, the scheme advisory board, or an independent body. A regime of regular formal reports to the Secretary of State could also be required.

4.12 The draft regulations also allow the Secretary of State to determine that sufficient improvement has been made to end the intervention before the review date. The administering authority may also make representations to the Secretary of State before that date, if it has clear evidence that the prescribed action is no longer appropriate.

## Questions

5. Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?
6. Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?
7. Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?

8. Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?

# Summary of the draft regulations

## **(1) Citation, commencement and extent**

This details the citation and scope of the draft regulations, and gives the date at which they will come into force.

## **(2) Interpretation**

These provisions define terms used in the draft regulations with reference to legislation, and cite the legislation that gives administering authorities the powers that may be impacted by the draft regulations.

## **(3) Investment**

This draft regulation defines what is considered an investment for the purposes of the regulations. This definition includes futures, options, derivatives, limited partnerships and some types of insurance contracts. It also defines who a person with whom a contract of insurance can be entered into is.

## **(4) Management of a pension fund**

This draft regulation lists the monies that an administering authority must credit to its pension fund, including employer and employee contributions, interest, and investment capital and income. It also sets out the administering authority's responsibility to pay benefits entitled to members, and states that, except where prohibited by other regulations, costs of administering the fund can be paid by the fund.

## **(5) Restriction on power to borrow**

This proposed regulation outlines the limited circumstances under which an administering authority can borrow money that the pension fund is liable to repay.

## **(6) Separate bank account**

The draft regulation states that an administering authority must deposit all pension fund monies in a separate account, and lists those institutions that can act as a deposit taker. It also states that the deposit taker cannot use pension fund account to set-off any other account held by the administering authority or a connected party.

## **(7) Investment strategy statement**

This draft regulation places an obligation on the administering authority to consult on and publish an investment strategy statement, which must be in accordance with guidance from the Secretary of State. The statement should demonstrate that investments will be suitably diversified, and it should outline the administering authority's maximum allocations for different asset classes, as well as their approach to risk and responsible investing.

In many respects, the investment strategy statement replaces the list of restrictions given in Schedule 1 of the 2009 Regulations and enables the criteria to be determined at local

level. Schedule 1 of the 2009 Regulations will remain in force until such time that the new investment strategy statements have to be published.

Provision is made for authorities to publish their policy on the extent to which environmental, social and corporate governance factors are taken into account in the selection, retention and realisation of investments.

Separate guidance will be issued by the Secretary of State that will clarify how the Government's recent announcement on boycotts, sanctions and disinvestment will be exercised.

### **(8) Directions by the Secretary of State**

This provision would grant the Secretary of State the power to intervene in the investment function of an administering authority if he is satisfied that the authority is failing to have regard to regulation and guidance. He can also initiate inquiries to determine if an intervention is warranted, and must consult with the authority concerned. Once it is determined that an intervention is needed, the Secretary of State can intervene by directing the authority undertake a broad range of actions to remedy the situation.

### **(9) Investment managers**

This draft regulation details how an administering authority must appoint external investment managers.

### **(10) Investments under section 11(1) of the Trustee Investments Act 1961**

This draft regulation allows administering authorities to invest in Treasury-approved collective investment schemes.

### **(11) Consequential amendments**

This proposed regulation lists the prior regulations that are amended by the draft amendments.

### **(12) Revocations and transitional provisions**

The draft provision lists the regulations that would be revoked if the draft regulations come into effect. It also proposes transitional arrangements to ensure that the existing regulations governing the investment strategy remain in place until a new investment strategy statement is published by an authority under draft regulation seven. These transitional arrangements would apply for up to six months after the draft regulations came into effect.

# Annex A: Members of the Investment Regulation Review Group

Alison Hamilton	Barnet Waddingham
Bob Claxton	Wandsworth Pension Fund
Clifford Sims	Squire Patton Boggs
Dawn Turner	Environment Agency Pension Fund
Geoff Reader	Bedford Pension Fund
Graeme Russell	Greater Gwent Pension Fund
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Loretta Stowers	Greater Manchester Pension Fund
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Nigel Keogh	Chartered Institute of Public Finance and Accountancy
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Peter Morris	Greater Manchester Pension Fund

**2016 No. 0000**

**PUBLIC SERVICE PENSIONS, ENGLAND AND WALES**

**The Local Government Pension Scheme (Management and  
Investment of Funds) Regulations 2016**

<i>Made</i>	- - - -	2016
<i>Laid before Parliament</i>		2016
<i>Coming into force</i>	- -	2016

These Regulations are made in exercise of the powers conferred by sections 1 and 3 of, and Schedule 3 to, the Public Service Pensions Act 2013(a).

In accordance with section 21 of that Act, the Secretary of State has consulted such persons and the representatives of such persons as appeared to the Secretary of State to be likely to be affected by these Regulations.

In accordance with section 3(5) of that Act, these Regulations are made with the consent of the Treasury.

The Secretary of State makes the following Regulations:

**Citation, commencement and extent**

1.—(1) These Regulations may be cited as the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

(2) These Regulations come into force on 1st April 2016.

(3) These Regulations extend to England and Wales.

**Interpretation**

2.—(1) In these Regulations—

“the 2000 Act” means the Financial Services and Markets Act 2000(b);

“the 2013 Regulations” means the Local Government Pension Scheme Regulations 2013(c);

“the Transitional Regulations” means the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014(d);

---

(a) 2013 c. 25  
(b) 2000 c.8.  
(c) S.I. 2013/2356.  
(d) S.I. 2014/525.

“authority” means an administering authority listed in Part 1 of Schedule 3 to the 2013 Regulations;

“fund money” means money that is or should be in a pension fund maintained by an authority;

“proper advice” means the advice of a person whom the authority reasonably believes to be qualified by their ability in and practical experience of financial matters;

“the Scheme” means the scheme established by the 2013 Regulations.

(2) Any restrictions imposed by these Regulations apply to authorities which have the power within section 1 of the Localism Act 2011<sup>(a)</sup> (local authority’s general power of competence) or section 5A(1) of the Fire and Rescue Services Act 2004<sup>(b)</sup> in the exercise of those powers.

(3) Any authority which does not have the powers mentioned in paragraph (2) has, by virtue of these Regulations the power to do anything authorised or required by these Regulations.

### **Investment**

3.—(1) In these Regulations “investment” and related expressions have their normal meaning.

(2) But the following provisions of this regulation specify things which count as investments for these Regulations, although they might not otherwise do so, and exclude things which might otherwise count.

(3) A contract entered into in the course of dealing in financial futures, traded options or derivatives is an investment.

(4) A contract of insurance is an investment if it is a contract of a relevant class, and is entered into with a person within paragraph (5) for whom entering into the contract constitutes the carrying on of a regulated activity within the meaning of section 22 of the 2000 Act<sup>(c)</sup>.

(5) The persons within this paragraph are—

(a) a person who has permission under Part 4A of the 2000 Act (permission to carry on regulated activities) to effect or carry out contracts of insurance of a relevant class;

(b) an EEA firm of the kind mentioned in paragraph 5(d) of Schedule 3 to the 2000 Act (EEA passport rights), which has permission under paragraph 15 of that Schedule<sup>(d)</sup> to effect or carry out contracts of insurance of a relevant class; and

(c) a person who does not fall within sub-paragraph (a) or (b) whose head office is in an EEA state other than the United Kingdom, and who is permitted by the law of that state to effect or carry out contracts of insurance of a relevant class.

(6) A contract of insurance is of a relevant class for the purposes of paragraphs (4) and (5) if it is—

(a) a contract of insurance on human life or a contract to pay an annuity on human life where the benefits are wholly or partly to be determined by reference to the value of, or income from, property of any description (whether or not specified in the contract) or by reference to fluctuations in, or an index of, the value of property of any description (whether or not so specified); or

(b) a contract to manage the investments of pension funds, whether or not combined with contracts of insurance covering either conservation of capital or payment of minimum interest.

(7) It is an investment to contribute to a limited partnership in an unquoted securities investment partnership.

(8) For the purposes of this regulation—

“limited partnership” has the meaning given in the Limited Partnerships Act 1907<sup>(a)</sup>;

---

(a) 2011 c. 20.

(b) 2004 c. 21; section 5A was inserted by section 9(1) of the Localism Act 2011.

(c) Section 22 was amended by section 7(1) of the Financial Services Act 2012 (c.21).

(d) Paragraph 15 was amended by S.I. 2007/126.



“recognised stock exchange” has the same meaning as in section 1005 of the Income Tax Act 2007(b);

“traded option” means an option quoted on a recognised stock exchange; and

“unquoted securities investment partnership” means a partnership for investing in securities which are not quoted on a recognised stock exchange when the partnership buys them.

### **Management of a pension fund**

4.—(1) An authority must credit to its pension fund(c), in addition to any sum otherwise required to be credited by virtue of the 2013 Regulations or the Transitional Regulations—

- (a) the amounts payable by it or payable to it under regulations 15(3), 67 and 68 of the 2013 Regulations (employer’s contributions and further payments);
- (b) all amounts received under regulation 69(1)(a) of the 2013 Regulations (member contributions);
- (c) all income arising from investment of the fund; and
- (d) all capital money deriving from such investment.

(2) In the case of an authority which maintains more than one pension fund, as respects sums which relate to specific members, the reference in paragraph (1) to the authority’s pension fund is to the fund which is the appropriate fund(d) for the member in question in accordance with the 2013 Regulations.

(3) Interest under regulation 71 of the 2013 Regulations (interest on late payments by Scheme employers) must be credited to the pension fund to which the overdue payment is due.

(4) An authority must pay any benefits to which any person is entitled by virtue of the 2013 Regulations or the Transitional Regulations from its pension fund.

(5) Any costs, charges and expenses incurred administering a pension fund may be paid from it except for charges prescribed by regulations made under sections 23, 24 or 41 of the Welfare Reform and Pensions Act 1999(e) (charges in relation to pension sharing costs)(f).

### **Restriction on power to borrow**

5.—(1) Except as provided in this regulation, an authority must not borrow money where the borrowing is liable to be repaid out of its pension fund.

(2) Subject to paragraph (3), an authority may borrow by way of temporary loan or overdraft which is liable to be repaid out of its pension fund, any sums which it may require for the purpose of—

- (a) paying benefits due under the Scheme; or
- (b) to meet investment commitments arising from the implementation of a decision by it to change the balance between different types of investment.

(3) An authority may only borrow money under paragraph (2) if, at the time of the borrowing, the authority reasonably believes that the sum borrowed and interest charged in respect of that sum can be repaid out of its pension fund within 90 days of the borrowing.

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(a) 1907 c. 24.

(b) 2007 c.3; section 1005 was substituted by the Finance Act 2007 (c. 11) and amended by the Taxation (International and Other Provisions) Act 2010 (c.8).

(c) An administering authority is required to maintain a pension fund by regulation 53(1) of, and paragraph 1 of Schedule 3 to the 2013 Regulations.

(d) See regulation 53(2) of and Part 2 of Schedule 3 to the 2013 Regulations for provisions relating to an administering authority becoming the “appropriate administering authority” in relation to a person.

(e) 1999 c. 30.

(f) See S.I. 2000/1047 and S.I. 2000/1049.

### Separate bank account

6.—(1) An authority must hold in a separate account kept by it with a deposit-taker all fund money.

(2) “Deposit-taker” for the purposes of paragraph (1) means—

- (a) a person who has permission under Part 4A(a) of the 2000 Act (permission to carry on regulated activities) to carry on the activities specified by article 5 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (accepting deposits)(b);
- (b) an EEA firm of the kind mentioned in paragraph 5(b)(c) of Schedule 3 to the 2000 Act (EEA passport rights) which has permission under paragraph 15 of that Schedule(d) to accept deposits;
- (c) the Bank of England or the central bank of an EEA state other than the United Kingdom;  
or
- (d) the National Savings Bank.

(3) An authority must secure that the deposit-taker may not exercise a right of set-off in relation to the account referred to in paragraph (1) in respect of any other account held by the authority or any party connected to the authority.

### Investment strategy statement

7.—(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State.

(2) The authority’s investment strategy must include—

- (a) a requirement to invest fund money in a wide variety of investments;
- (b) the authority’s assessment of the suitability of particular investments and types of investments;
- (c) the authority’s approach to risk, including the ways in which risks are to be measured and managed;
- (d) the authority’s approach to pooling investments, including the use of collective investment vehicles and shared services;
- (e) the authority’s policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
- (f) the authority’s policy on the exercise of the rights (including voting rights) attaching to investments.

(3) The authority’s investment strategy must set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment.

(4) The authority’s investment strategy may not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007(e).

(5) The authority must consult such persons as it considers appropriate as to the contents of its investment strategy.

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(a) Part 4A was inserted by section 11 of the Financial Services Act 2012 (c. 21).  
(b) S.I. 2001/544; article 5 was amended by S.I. 2002/682.  
(c) Sub-paragraph (b) of paragraph (5) was substituted by S.I. 2006/3211 and then further substituted by S.I. 2013/3115.  
(d) Paragraph 15 has been amended by S.I. 2003/2066, S.I. 2007/3253, 2012/1906 and 2013/1881.  
(e) 2007 c. 28; section 212 was amended by the Police Reform and Social Responsibility Act 2011 (c. 13) and there are prospective amendments made by the Local Audit and Accountability Act 2014 (c. 2).

(6) The authority must publish a statement of its investment strategy formulated under paragraph (1) and the first such statement must be published no later than 1st October 2016.

(7) The authority must review and if necessary revise its investment strategy from time to time, and at least every 3 years, and publish a statement of any revisions.

(8) The authority must invest, in accordance with its investment strategy, any fund money that is not needed immediately to make payments from the fund.

### **Directions by the Secretary of State**

**8.—**(1) This regulation applies in relation to an authority's investment functions under these Regulations and the 2013 Regulations if the Secretary of State is satisfied that the authority is failing to have regard to guidance issued under regulation 7(1) (investment strategy statement).

(2) Where this regulation applies in relation to an authority the Secretary of State may issue a direction requiring all or any of the following—

- (a) that the authority make such changes to its investment strategy under regulation 7 as the Secretary of State considers appropriate, within a period of time specified in the direction;
- (b) that the authority invest such assets or descriptions of assets as are specified in the direction in such manner as is specified in the direction;
- (c) that the investment functions of the authority under these Regulations and under the 2013 Regulations be exercised by the Secretary of State or a person nominated by the Secretary of State for a period specified in the direction or for so long as the Secretary of State considers appropriate;
- (d) that the authority comply with any instructions of the Secretary of State or the Secretary of State's nominee in relation to the exercise of its investment functions under these Regulations and the 2013 Regulations and provide such assistance as the Secretary of State or the Secretary of State's nominee may require for the purpose of exercising those functions.

(3) Before making a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must consult the authority concerned.

(4) In reaching a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must have regard to such evidence of the manner in which the authority is discharging or proposes to discharge its investment functions as is reasonably available including—

- (a) any report from an actuary appointed under section 13(4) of the Public Service Pensions Act 2013 (employer contributions in funded schemes) or by the authority under section 62 of the 2013 Regulations (actuarial valuations of pension funds);
- (b) any report from the local pension board appointed by the authority or from the Local Government Pension Scheme Advisory Board<sup>(a)</sup>;
- (c) any representations made by the authority in response to the consultation under paragraph (3);
- (d) any other evidence available that the Secretary of State regards as relevant to whether the authority has been complying with these regulations or acting in accordance with guidance issued under regulation 7(1) (investment strategy statement).

(5) If the Secretary of State is of the opinion that additional information is required to enable a decision to be taken whether to issue a direction under this regulation, or as to what any direction should contain, the Secretary of State may carry out such inquiries as the Secretary of State considers appropriate to obtain that information.

(6) An authority must co-operate with any request from the Secretary of State intended to facilitate the obtaining of information under paragraph (5).

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(a) The Local Government Pension Scheme Advisory Board is established under regulation 110 of the 2013 Regulations (which was inserted by S.I. 2015/57).

## **Investment managers**

**9.**—(1) Instead of managing and investing fund money itself, an authority may appoint one or more investment managers to manage and invest fund money, or any part of such money, on its behalf.

(2) The authority must reasonably believe that the investment manager's ability in and practical experience of financial matters make that investment manager suitably qualified to make investment decisions for it.

(3) The authority must take proper advice in relation to the appointment and the terms on which the appointment is made.

## **Investments under section 11(1) of the Trustee Investments Act 1961**

**10.** An authority to which section 11 of the Trustee Investments Act 1961(a) applies may invest, without any restriction as to quantity, in any investment made in accordance with a scheme under section 11(1) of that Act (which enables the Treasury to approve schemes for local authorities to invest in collectively).

## **Consequential amendments**

**11.**—(1) The 2013 Regulations are amended as follows.

(2) For regulation 57(1)(a) (pension fund annual report) substitute—

“(i) the current version of the investment strategy under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016;”.

(3) For regulation 58(4)(b) (funding strategy statement) substitute—

“(b) the statement of the administering authority's investment strategy published under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.”.

(4) For regulation 69(2)(b) (payment by Scheme employers to administering authorities) substitute—

“(b) paragraph (1)(c) does not apply where the cost of the administration of the fund is paid out of the fund under regulation 4(5) (management of a pension fund) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.”.

## **Revocations and transitional provision**

**12.**—(1) Subject to paragraph (2), the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009(b) and the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013(c) are revoked.

(2) Regulations 11 (investment policy and investment of pension fund money), 12 (statement of investment principles), 14 (restrictions on investments), 15 (requirements for increased limits) of and Schedule 1 (table of limits on investments) to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 continue to have effect in relation to an authority until the date when that authority publishes its investment strategy statement under regulation 7(1) (investment strategy statement).

(3) For the period starting on 1st April 2016 and ending on whichever is the earlier of the date the authority publishes its investment strategy statement under regulation 7 (investment strategy

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(a) 1961 c. 62; section 11(1) was amended by the London Government Act 1963 (c. 4) and the Local Government Act 1985 (c. 51).

(b) S.I. 2009/3093.

(c) S.I. 2013/410.

statement), or 30th September 2016, Regulation 7 applies to an authority only to the extent necessary to enable that authority to formulate and publish its investment strategy statement.

We consent to the making of these Regulations

Date *Names*  
Two of the Lords Commissioners of Her Majesty's Treasury

Signed by authority of the Secretary of State for Communities and Local Government

Date *Name*  
Parliamentary Under Secretary of State  
Department for Communities and Local Government

**EXPLANATORY NOTE**

*(This note is not part of the Regulations)*

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# *Cabinet Office and Department for Communities and Local Government*

*Cabinet Office and  
DCLG*

*November 2015*

Design of the structure and  
governance of efficient and  
effective CIVs for LGPS  
Funds



**Cabinet Office**  
70 Whitehall  
London, SW1A 2AS

and

**Department for Communities  
and Local Government**  
2 Marsham Street  
London, SW1P 4DF

20<sup>th</sup> November 2015

Dear Sirs,

**Design of the structure and governance of efficient and effective CIVs for LGPS Funds**

We enclose our revised report on the design of the structure and governance of efficient and effective collective investment vehicles (“CIVs”) for LGPS Funds (the “Report”). The Report has been produced in accordance with the instructions in the Award Letter dated 4<sup>th</sup> December 2014.

The Report sets out our analysis of certain technical aspects (legal, regulatory and tax) for the CIV structure as well as some governance and operational considerations. The analysis in this Report is based on the law and our understanding of the prevailing interpretation and practice of the relevant authorities as at 22<sup>nd</sup> December 2014.

The Report has been adjusted at your request from an earlier report on the same subject so that it is consistent with paragraph 2.19 of the red book issued as part of the Chancellor’s Summer 2015 Budget, which invited ambitious proposals for pooling.

In accordance with the Award Letter and discussions with the Cabinet Office and the Department for Communities and Local Government (“DCLG”) we address this Report solely to the Cabinet Office and DCLG.

It has been a pleasure to work with you on these matters. If you have any queries please do not hesitate to contact us.

Yours faithfully,

Amanda Rowland  
Partner, Asset Management Regulatory

Mark Packham  
Director, Public Sector Pensions

cc Clifford Sims, Squire Patton  
Boggs

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# ***1. Executive Summary***

## ***1.1 Introduction***

This Report, in accordance with the agreed scope for our work, sets out a possible approach for Collective Investment Vehicles (“CIVs”) for LGPS Funds, using the Authorised Contractual Scheme (“ACS”). In our view, based on the scope and objectives, the ACS structure is the best way for the LGPS to establish suitable and effective CIVs from a legal, tax and regulatory perspective.

We have examined the ACS structure for its applicability in pooling the listed assets of the 89 LGPS Funds in England and Wales. We have drawn up a number of options for the construction or procurement of ACS Operators for further consideration, and we have suggested a governance context that would allow effective participation by groups of LGPS Funds.

This Executive Summary provides a brief outline of the main characteristics of the proposed structures and entities. We strongly recommend that it is read in the context of the detailed sections which follow (having reference to the Glossary in appendix 1) as they provide further context and develop important themes introduced here.

The scope and your instructions did not include consideration of structures other than CIVs, such as Joint Committees, Frameworks or Joint Procurement, or the best approach for holding unlisted assets within a CIV.

## ***1.2 Features of the ACS structure***

We have concluded that the ACS is the most appropriate model for the pooling of certain assets of the 89 LGPS Funds into CIVs. The ACS was introduced into the UK funds landscape in 2013.

Of the two available forms for an ACS the co-ownership model whereby the LGPS Funds will hold units in the ACS is the most suitable for this purpose. This model permits the operation of a number of sub-funds under the one vehicle resulting in greater efficiency in terms of both establishment and ongoing costs than other alternatives.

A co-ownership ACS is not itself subject to UK corporation tax, income tax or capital gains tax. The co-ownership ACS is tax transparent for income. Pension funds typically favour tax transparent vehicles so that they do not suffer 'tax drag' on their overseas investment returns. Management services supplied to the ACS should be exempt from VAT under the management of 'special investment funds' exemption. The tax position is described in greater detail in Section 3.4.

ACSs and their Operators will require authorisation by the FCA and will be subject to its ongoing supervision. Each sub fund of the ACS may have its own investment objectives and different investment managers may be appointed for each thereby allowing the ACS to benefit from the full range of cost efficiency, expertise and market performance available in the market.

The preferred investment scheme for an ACS is the Qualified Investor Scheme (“QIS”). A QIS has very wide powers of investment, both in terms of asset type and concentration. It will therefore offer a wide range of investment freedoms and gives the potential for one type of CIV that can accommodate many asset classes should this be desirable.

## 1.3 Delivery models for the Operator

The ACS structure requires there to be an Operator, to be authorised by the FCA. There are two main potential delivery models for an Operator: build or appoint. Both options are set out with an analysis for decision-making. Ultimately, the choice between them will depend on the priority given to the criteria used to decide between them.

- Building an Operator may score highly as a way to engage participating LGPS Funds and to ensure value for money.
- Appointing an Operator is the faster and the lowest initial cost route to setting up an ACS, but the route would rely on successful initial commercial negotiation, partnership working and rigorous change management during the contractual period if unforeseen costs are to be avoided.

Delivery models involving private sector partners have lower initial set up costs. However, it is very likely that these costs will ultimately be passed back as operating costs over the life of commercial agreements.

## 1.4 The governance context

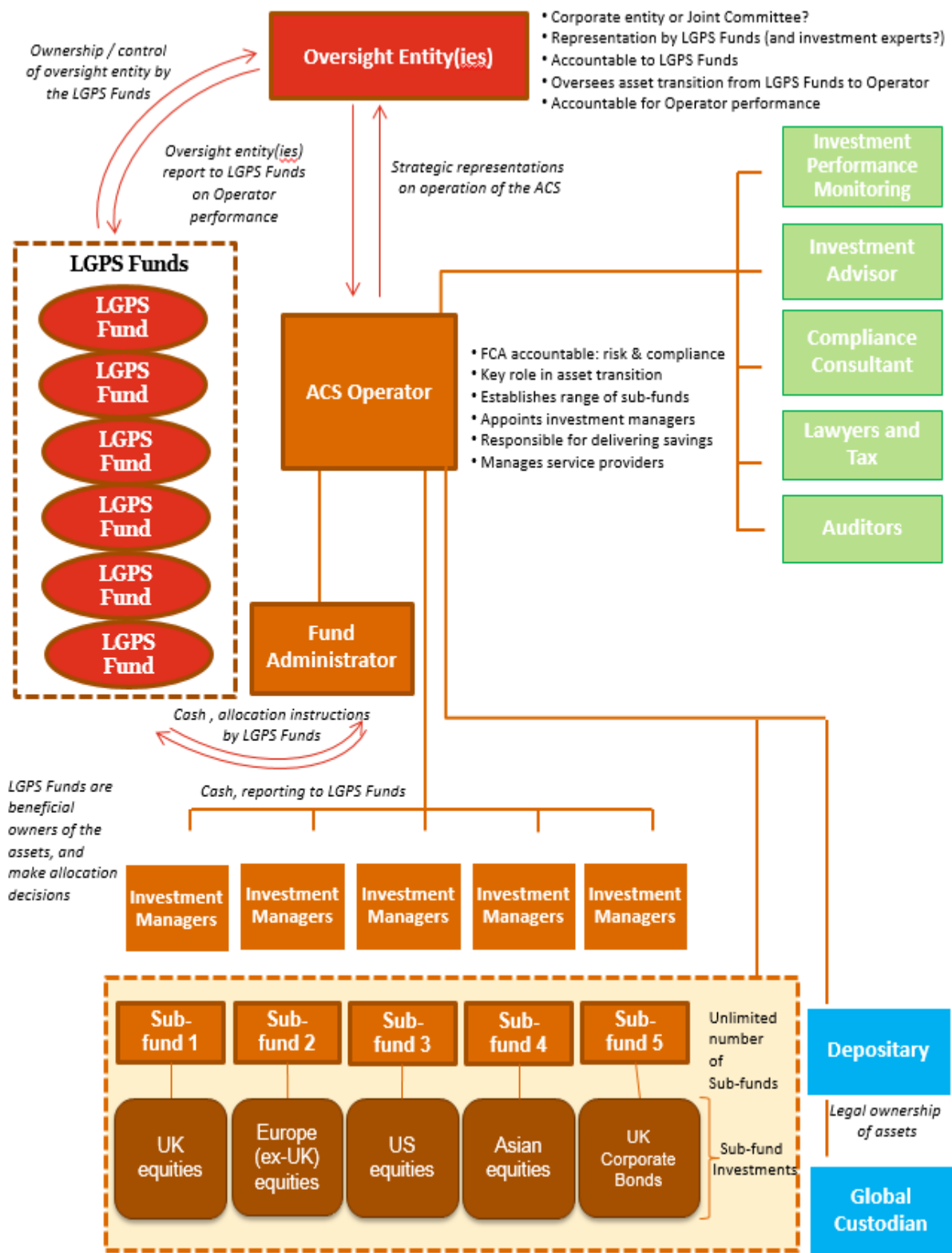
A practical way to separate the operational and oversight functions will be needed. The Operator would be responsible for delivering the envisaged savings, and its key functions will be to establish investment sub-funds, and to appoint, manage and dismiss investment managers to operate them.

Oversight would then be by a separate body or bodies. These might include a Joint Committee or a corporate entity, or a combination of entities. They would be accountable to the LGPS Funds which participate in a given CIV or ACS for the performance of the Operator.

The primary benefits of the separation of the operator and oversight functions are:

- As a body that does not require FCA regulation, the oversight entities could bring a range of perspectives to the oversight role. The participating LGPS Funds would be properly represented, channelling their voices through the oversight entities.
- The Operator can focus solely on meeting investment challenges, to deliver investment savings and performance for the LGPS as a whole, delivering long term investment performance, at scale, in each asset class that it offers.
- The ability, if using the build model, to deliver an Operator that meets the precise investment needs of the participating LGPS Funds.

The wider governance context is illustrated in the schematic below. From the perspective of the participating LGPS Funds, there would be non-executive input through the oversight entities. Day to day interactions involving cash flows and asset allocation instructions would be through the Administrator appointed by the Operator. The investment performance of each LGPS Fund would depend on its choice of asset allocation, with reliance on the Operator to deliver effective performance from each sub-fund.



# 2. Introduction

## 2.1 Background

At the time we conducted research for this Report, the Cabinet Office and DCLG were working together to consider potential reforms to the way in which the 89 LGPS Funds in England and Wales could be operated and invested. The overall aim of any proposed reform was understood to be the delivery of administration and investment management savings to support the long term sustainability of LGPS. It had been recognised that by far the greater savings would arise from new investment approaches. This Report considers only the investment management structure and its operation, as described below.

The prior Consultation on the subject (which opened on 1 May 2014 and closed on 11 July 2014) was predicated on the basis that the LGPS Funds would not merge and would retain responsibility for asset allocation between asset classes. There was also an assumption that significant savings can be achieved from greater use of passive management within some listed asset classes and that a CIV or CIVs should be established for listed and alternative asset classes.

Before putting proposals to Ministers, the Cabinet Office and DCLG wished to obtain advice on various technical and operational considerations, associated with the CIV approach. PwC (“We”) were therefore engaged to provide advice in the specific areas set out below.

Acronyms and other defined terms are listed in the Glossary (Appendix 1) for ease of reference.

## 2.2 Scope

We were engaged under the Award Letter to undertake a preliminary piece of work with focus only on a limited range of specific issues, namely:-

- A technical analysis of possible design options for CIVs, focusing in particular on legal, tax and regulatory issues in relation to listed assets;
- Presentation of options for operational structures for the preferred CIV model; and
- The governance arrangements for such model(s) with emphasis on achieving an effective governance framework with LGPS Fund representation.

Specifically excluded from the scope of our work were:-

- Consideration of the ownership structure of CIVs and whether participation would be voluntary;
- Analysis of any aspect of transition of assets to a CIV;
- Comparison of different investment models (for example passive or active) for asset classes;
- Consideration of costs of ongoing ownership; and
- Any analysis of the implications of the IORP Directive (“IORP”) applying to the LGPS, given that you had told us that Central Government would be considering this issue separately.

In preparing this Report, we have relied on legal advice provided to us by our sub-contractor Squire Patton Boggs (UK) LLP (“SPB”). Neither PwC nor SPB accepts liability to any third parties in respect of any legal opinions expressed in this Report. Third parties are advised to take independent legal advice in respect of any legal matters arising out of this Report.

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This document has been prepared only for the Cabinet Office and DCLG and solely for the purpose and on the terms agreed with the Cabinet Office and DCLG in our agreement dated 4 December 2014. We accept no liability (including for negligence) to anyone else in connection with this Report, and it may not be provided to anyone else without our prior agreement.

The analysis in this Report is based on the law and our understanding of the prevailing interpretation and practice of the relevant authorities as at 22 December 2014.



# 3. Technical analysis of the investment vehicle

## 3.1 Selection of Entity Structure

In selecting the most appropriate entity structure for a CIV for a group of participating LGPS Funds we considered the following possible forms:-

- authorised unit trust (“AUT”);
- open-ended investment company (“OEIC”);
- limited partnership (“LP”);
- authorised contractual scheme (“ACS”) – which can take the form of a limited partnership or a co-ownership scheme; and
- unit-linked life assurance fund.

These were the vehicles identified in the Hymans Robertson report of December 2013 (LGPS structure analysis) (the “December 2013 Report”). The selection of these vehicles was made partly on the basis of the current LGPS Investment Regulations (which expressly reference four of the five vehicles) and partly to recognise the introduction of the ACS as an alternative CIV even though the LGPS Investment Regulations are silent on the ACS. We have set out brief comparative information below to show how the choice of entity structure for the CIV was reached.

### 3.1.1 AUT

AUTs are established under section 242 of the Financial Services and Markets Act, 2000 (“FSMA”). These are schemes established by trust deed between the authorised fund manager (“AFM”) and the trustee. They are regulated by the Financial Conduct Authority (“FCA”) and must be authorised before they can be launched to investors. The AFM is considered the operator of the AUT and takes on all regulatory responsibility for the scheme; this includes ensuring it is investing in accordance with its investment powers and investment policies. The trustee is responsible for keeping the AUT’s investments in safekeeping and is responsible for overseeing the AFM, ensuring it is acting in accordance with the FCA’s rules.

An AUT may have an unlimited number of sub-funds which may have investment strategies and objectives independent of each other. However, such sub-funds do not have the same legal separation as exists for segregated sub-funds of an OEIC or ACS.

An AUT is a tax opaque entity. AUTs are exempt from UK tax on capital gains and subject to a 20% tax on income. However, as UK and foreign dividends are exempt from tax and relief is available for expenses (e.g. management, depositary/trustee, authorisations and audit fees in the case of equity funds), such funds typically pay minimal UK Corporation Tax. AUTs have access to many of the UK’s tax treaties in their own right.

### 3.1.2 OEIC

OEICs are created under the OEIC Regulations. An OEIC is established as a body corporate in its own right. One of the directors must be the authorised corporate director (“ACD”) which is responsible for the regulatory oversight and operator role of the OEIC. OEICs are regulated by the FCA and must be authorised before they can be launched to investors. The ACD takes on a similar role to the AFM in an AUT. The OEIC must have a depositary, which has similar responsibilities (of safekeeping and oversight over the ACD) to the trustee of an AUT.

As with an AUT, an OEIC may have an unlimited number of sub-funds, each of which may have investment strategies and objectives independent of each other. As for an AUT, an OEIC is a tax opaque entity. OEICs are taxed in broadly the same way as AUTs.

### **3.1.3 LP**

LPs are unregulated schemes, although any LP would need an entity authorised by the FCA to operate it. Assuming the LP would be an alternative investment fund (“AIF”) under the alternative investment fund managers directive (“AIFMD”), the Operator would require authorisation as an alternative investment fund manager (AIFM). An LP is set up between a general partner and the investors, who become limited partners in the scheme under a partnership deed meeting the requirements of the Limited Partnerships Act 1907.

An LP can only be a standalone scheme, meaning it is necessary either to mix all investments and investment strategies within the same LP, or to set up several LPs to handle different investment strategies (for example, one LP for UK equities, one LP for Europe ex-UK equities and so on). It cannot therefore accommodate an umbrella structure in the same way as an AUT, OEIC or ACS.

An LP is a tax transparent entity; this means that all income and gains from underlying investments would be treated as arising directly to investors. No UK corporation tax would be payable at the vehicle level

### **3.1.4 ACS**

ACS were introduced as a potential form of investment vehicle in 2013. They can take two different forms, these being a limited partnership (a regulated version of the structure described in 3.1.3) and a co-ownership scheme established by a contractual deed between the ACS operator and the trustee. The ACS operator and trustee have similar roles to the AFM and trustee of an AUT. Both types of ACS are regulated by the FCA and must be authorised before they can be introduced to investors.

The co-ownership ACS may be created as an umbrella scheme with an unlimited number of sub-funds which may have investment strategies and objectives independent of each other. As with an unregulated LP, a limited partnership ACS can only be a standalone scheme meaning it would be necessary either to mix all investments, and investment strategies, within the same LP or set up several LPs to handle different investment strategies (for example, one LP for UK equities, one LP for Europe ex-UK equities and so on).

The tax treatment of the LP version of the structure should follow that of the LP described above. The co-ownership scheme has been designed with the objective of being tax transparent to income, but tax opaque for capital gains This ACS should be exempt from UK corporation tax on capital gains in the same way as UK AUTs and OEICs.

### **3.1.5 Unit-linked fund**

A unit-linked life fund is solely owned by the establishing insurance company. Unlike the other structures described here a unit-linked fund sits outside the UK definition of a Collective Investment Scheme (“CIS”) in section 235 FSMA. The fund sits on the balance sheet of the insurance company rather than having a depositary/trustee responsible for the assets. Investors also own no part of the underlying investments; instead they have contractual rights as policyholders.

Sub-sections of a life company’s fund can be created but because the life company owns the assets, this sectionalisation is really an accounting tool rather than a way of creating an effective legal separation of assets.

### **3.1.6 Rationale for selection of a co-ownership ACS**

As a result of our analysis, briefly summarised above, we have determined the most suitable CIV legal structure for the LGPS Funds to be a co-ownership ACS.

Firstly, we considered that a regulated entity with the protective restrictions placed over it would be more appropriate than an unregulated structure given the nature of the assets and interests within it. This

discounted the unauthorised LP as an appropriate entity. There was also the additional complexity of requiring a potentially large number of similar entities to cover different investment strategies resulting in more inefficiencies and higher costs. The tax position of the LP is similar to and no more advantageous than the ACS.

Secondly, we discounted the unit linked fund as it would not afford the participating LGPS Funds the right of ownership over the underlying assets themselves and has an inferior tax position in some respects. We believe this would be an unattractive proposition.

The regulatory rules under which AUT, OEIC and ACS operate are largely the same and often driven by scheme type rather than legal structure (section 3.2 has more information on scheme type). Of the three, we concluded that the ACS is the preferred choice because it is likely to offer the most tax efficient solution for the LGPS Funds as a result of its tax transparency. The tax treatment of a co-ownership ACS is discussed in more detail in section 3.4.

Of the two forms of ACS, we consider the co-ownership vehicle, set up under contract, to be favourable to a limited partnership ACS in this case. This is primarily because the limited partnership scheme would require a number of investment schemes to be established as it cannot operate as an umbrella scheme. This would almost certainly increase both establishment and ongoing costs. The co-ownership ACS, on the other hand, may operate a number of sub-funds under one investment structure and thereby offers simplicity and efficiency of structure. Additionally, the structure provides the LGPS Funds with an ownership interest directly related to the scheme assets in that the LGPS Funds will hold units in the ACS and will be beneficial owners of the ACS assets as tenants in common.

## ***3.2 Choice of scheme type***

With the structure of the entity being a co-ownership ACS the investment scheme may be established as:

- an undertaking for collective investment in transferable securities (“UCITS”);
- a non-UCITS retail scheme (“NURS”); or
- a qualified investor scheme (“QIS”).

Whilst a scheme can have an unlimited number of sub-funds these must all be the same as the scheme type – for example, a UCITS ACS could only have sub-funds meeting the UCITS requirements.

### ***3.2.1 Rationale for choosing a QIS***

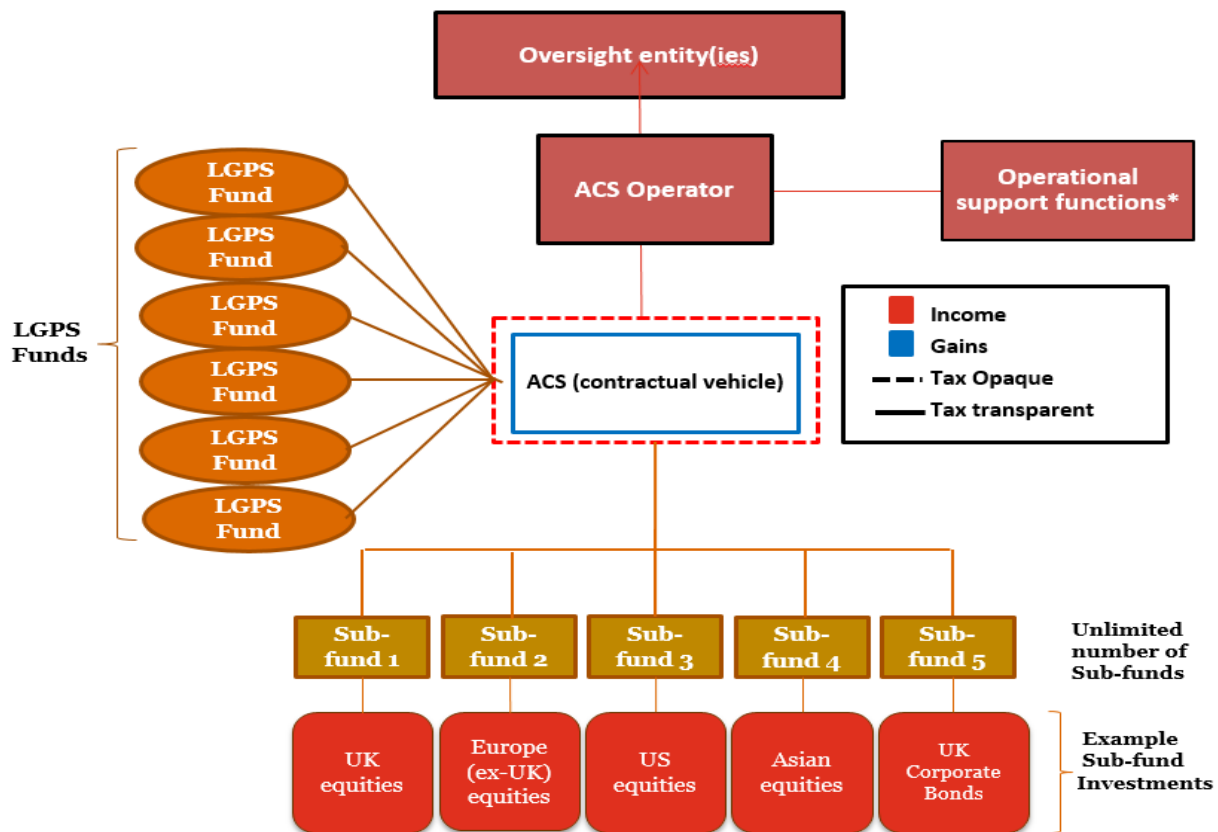
Given the objectives of the proposed structure, we believe a QIS to be the most suitable scheme type for the new ACS. A QIS has very wide powers regarding the types of assets in which it can invest (which includes all specified investments in the Financial Services and Markets Act (Regulated Activities) Order (“RAO”) and can hold any concentration of assets as long as this fits with its investment policy and investment strategy. It therefore offers a wide range of investment freedoms and may track an index both actively or passively through other tracker funds. Index-tracking is possible through both UCITS and NURS but these introduce more regulatory requirements and more restrictive investment powers which also require careful monitoring.

Further, establishing the ACS as a QIS provides a vehicle which can invest in a wide range of alternative assets and thereby may enable use of one type of CIV structure for all investment types.

Appendix 2 sets out a comparative table of the three scheme types and description of the UCITS and NURS schemes.

## 3.3 Authorised Contractual Scheme (ACS) Analysis

### 3.3.1 Background to an ACS



\*the operational support functions are detailed in the diagram included in section 4.

The FCA's rules for the authorisation of an ACS came into force on 1 July 2013. The main regulations are set out in Statutory Instrument (SI) 2013/1388 Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013.

The ACS will be operated by the Operator, which will be either an AIFM or a UCITS Management Company depending on whether the scheme is a NURS/QIS (AIFM) or UCITS (UCITS Management Company). As set out in more detail in section 4 of the Report, an oversight entity(ies) would oversee the Operator, though the Operator itself is responsible for all regulatory requirements relating to itself and the ACS.

The co-ownership ACS and the Operator will both need to be authorised by the FCA before they can begin to provide services (see section 3.5). The ACS may have an unlimited number of sub-funds to meet the investment needs and asset allocations of the LGPS Funds. As set out in section 3.6 each sub-fund is protected by FSMA from meeting the losses of any of the other sub-funds. Each LGPS Fund is also protected from a requirement to make good any losses in a sub-fund in which it owns units, over and above the capital already invested.

Each sub-fund of the ACS may have its own investment objective (e.g. seeking capital or income return over particular time periods) and invest in its own assets. Further, each sub-fund may have a different (or a

number of) investment managers appointed. This means that specific investment manager(s) selected for cost efficiency, performance record or expertise in a particular investment form, or asset class may be appointed by the Operator.

### *3.3.2 What is tax transparent pooling and what are its benefits?*

When HM Treasury established the ACS, it intended that it would work, in tax terms, in broadly the same way as competing existing equivalent vehicles do e.g. the Luxembourg Fonds Commun de Placement (“FCP”) and the Irish Common Contractual Fund (“CCF”). This involved drafting the legislation to try to ensure foreign tax authorities would regard the vehicle as transparent for income tax purposes, as well as deeming the units to be treated as shares for UK capital gains tax purposes only.

Investment pooling is the term used to describe the aggregation of different investors’ assets into a common fund vehicle. It offers investors the opportunity to diversify their portfolio and spread portfolio risk, and to achieve centralised administration, enhanced governance and risk management, and cost savings from economies of scale. Pooling can take place through a vehicle which is opaque for tax purposes, or one which is regarded as tax transparent.

The pooling of assets in a fund which is transparent for tax purposes means that income and gains from investments made by the fund accrue to each investor in proportion to its holding in the fund, without changing their character, source and timing. In other words, the fund is “looked through”, and investors are treated for tax purposes as if they held their proportionate share of the underlying investments directly.

The benefit of this is that investors should be able to access the treaty benefits of their home jurisdiction, provided that both the jurisdiction of the investor and investment view the fund as tax transparent. Where viewed as tax transparent, this will allow investors to take full advantage of the relevant double tax agreement as if they had invested directly, while achieving the administrative benefits and scale efficiencies of pooling.

Where the pooling vehicle is regarded as tax transparent, withholding tax rates are applied based on the double taxation treaties concluded between the country of the investor and the country of the underlying investments. This allows investors such as pension funds, which are often eligible for a reduced withholding tax rate, to benefit from that rate as if they held the investments directly. The difference between withholding tax rates for pension funds investing in US equities through a tax transparent and non-tax transparent vehicle can be up to 30% and points to the clear advantage of a tax transparent pooling vehicle in such a case.

In addition, it is usually preferable that the master fund in the master/feeder structure introduced by the UCITS IV Directive is tax transparent, in order to be attractive to feeder funds in different jurisdictions with different tax profiles.

An example of an ACS pooling arrangement can be seen on the diagram in section 3.3.1 above.

## *3.4 Tax treatment of a contractual ACS*

### *3.4.1 UK tax at the fund level*

#### **Income**

A contractual ACS does not have its own legal personality and as such, is not within the charge to direct UK tax (ACS are specifically excluded from the definition of a company for the purposes of the Corporation Tax Acts by CTA2010/S2212(1)). Consequently, the LGPS Funds, as participants in an ACS, would be liable to tax on their proportionate share of the net income of each sub-fund in which they invest. However, one would anticipate that the LGPS Funds would be exempt from UK tax on any net income allocation by virtue of their status as UK registered pension schemes.

## Capital gains

Capital gains are not treated as arising on a participant's share of assets held in a sub-fund, but instead, a unit in an ACS is treated as if it were an asset purely for the purposes of tax on capital gains. Investors in an ACS are therefore subject to capital gains made on their interest in an ACS and not on movements in the underlying assets of an ACS. As such, for the purposes of UK tax on chargeable gains only, the ACS units are deemed to be shares in a company with the result that UK unit holders will not be liable to tax on chargeable gains realised by each sub-fund.<sup>1</sup> UK unit holders may instead be liable to tax on chargeable gains arising from the redemption, transfer or other disposal of ACS units depending on their own UK tax status. In particular, as the LGPS Funds are registered pension schemes, they would not be expected to be subject to capital gains tax on disposal or redemption of ACS units.

Switches between units in one sub-fund of an ACS to units in another sub-fund should generally be treated as a disposal for this purpose, but conversions of units between classes within a sub-fund should not.

### *3.4.2 Foreign tax considerations*

On the international tax front, the ACS has been designed in such a way that it should generally qualify for tax transparent treatment in overseas jurisdictions, although ultimately this will be a matter for local fiscal authorities to determine.

We expect ACS to be regarded as tax transparent in at least all the jurisdictions that accept the tax transparency of Luxembourg FCPs, as they have been designed with many similar key features. As a result investors in them will qualify for double tax convention-reduced rates of withholding tax on their underlying investments.

Whilst HMRC initially indicated its intention to write to its foreign counterparts to explain the new ACS scheme and to follow this up with informal contacts to seek views on whether these overseas jurisdictions would treat UK co-ownership schemes as tax transparent, at the time of writing, no such correspondence has been issued.

In the event it is decided to proceed with the ACS, it would be necessary to obtain confirmation from the tax authorities in the relevant tax jurisdictions that they would in fact regard the ACS as tax transparent. The UK tax authorities would support any such approach.

Where practical and appropriate, we anticipate that investment managers for an ACS ("ACS providers") would seek to achieve reduced rates of withholding tax on foreign source income at source. To facilitate this, we anticipate that ACS providers will require each unit holder to supply the appropriate tax information forms for particular income types. If it is not practical or possible for any reason to claim relief at source, then the unit holders may in certain circumstances be able to make their own tax reclaims.

Tax transparency is considered to be a desirable characteristic of an investment vehicle, as generally pension schemes can access much more preferential rates of withholding taxes in accordance with the UK's global tax treaty network. For example, the rate of withholding tax on US securities is 30%. This can be reduced to 15% for UK AUTs and OEICs. UK pension schemes, as LGPS Funds, access a tax treaty rate of 0%.

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<sup>1</sup> The new s103D TCGA brings ACS units into s99B, which provides for units to be treated as shares in a company for chargeable gains purposes.



### 3.4.3 ACS Establishment: seeding arrangements

#### 3.4.3.1 UK tax matters

##### **Capital gains taxes**

As a result of a legislative exemption, it will be possible to seed an ACS with existing assets without triggering a UK capital gains tax charge in the hands of the contributor.

##### **Stamp taxes**

###### *a) Stamp Duty Reserve Tax (“SDRT”)*

Transfers of securities to a co-ownership scheme in consideration for an issue of units in it (i.e. an in specie seeding) are exempt from SDRT and stamp duty. Further, transfers of securities between sub-funds in an umbrella co-ownership scheme, are also exempt (this relief was granted to match the position in Luxembourg FCPs and Irish CCFs). There is also an exemption for the transfer of units in a co-ownership scheme.

###### *b) Stamp Duty Land Tax (“SDLT”)*

If the participating Funds were to consider seeding property into the ACS, then they should currently be able to do so without triggering an SDLT charge. However, it should be noted that as part of the recent budget announcements, HMRC is considering introducing some anti-avoidance tax legislation in this area. What this may look like is the subject of ongoing consultation and consideration.

#### 3.4.3.2 Foreign tax considerations

The mitigation of potential overseas capital gains taxes and potential overseas transaction taxes should be carefully considered on a jurisdiction by jurisdiction basis in order to minimise potential transaction costs.

### 3.4.4 Exit arrangements

#### 3.4.4.1 UK tax matters

##### **Liquidations**

Capital gains tax would be payable on redemption of the units, which would be treated as a disposal of a share for capital gains tax purposes. However, pensions funds are exempt from UK capital gains taxes, so no such tax should become payable.

##### **In specie redemptions**

The investment managers may, in redeeming ACS units, decide to pay out in a form other than cash. No capital gains tax should arise in the ACS on the in-specie redemption. Where this is done, it would be treated as a disposal of the ACS units by the investor and an acquisition of the in-specie assets received at fair value.

##### **Stamp tax considerations**

If an ACS is wound up and its assets are distributed in specie to investors, this should not trigger an SDRT charge. No comment is provided on SDLT at this stage.

## VAT considerations

The VAT treatment of the ACS is attractively simple. The supply of management services to tax transparent funds such as the ACS is VAT exempt<sup>2</sup>, just as it is with OEICs and AUT.

### 3.4.4.2 Foreign tax considerations

The mitigation of potential overseas capital gains taxes and potential overseas transaction taxes should be carefully considered on a jurisdiction by jurisdiction basis in order to minimise potential transaction costs.

## 3.4.5 The QIS tax regulations

As mentioned previously, a QIS scheme is a type of AIF which can accept more ‘sophisticated’ investors, but is still subject to regulation by the FCA. The reason that a QIS structure is put forward is that a QIS has wider investment and borrowing powers than other AIFs, but is subject to lighter regulation as it is only open to ‘qualified investors’.

Investors in a QIS may be corporates and other institutional investors (such as pension funds and charities) or sophisticated individual investors who regularly invest significant sums and can be expected to understand the risks associated with a wide range of investments.

Some established anti-avoidance tax legislation included in the QIS tax regulations (Regulation 14B SI2006/964) requires that an ACS should be “widely marketed” in order to avoid becoming subject to direct UK corporation tax.

However, since a contractual ACS is outside of the scope of direct UK tax (see 3.4.1) this potential piece of anti-avoidance legislation should not be in point.

## 3.5 Regulatory considerations

### 3.5.1 The ACS investment fund

An ACS will need to be authorised by the FCA before it can be launched and made available to participating LGPS Funds. An application will need to be submitted to the FCA’s Fund Authorisation and Supervision team (“FAS”) seeking authorisation. It will also be supervised on an ongoing basis by FAS. This application is similar for UCITS, NURS and QIS but there are some nuances as shown in the following table.

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<sup>2</sup> SI 2013/1401 amends item 9 and Note 6 of Group 5 of Schedule 9 to the Value Added Tax Act 1994 (c.23) to insert ACS into the list of schemes and/or undertakings the management of which are exempt from VAT



	UCITS	NURS	QIS
<b>Application form</b>	Form 261C	Form 261C and submit a new fund under management application (AIFMD requirement)	Form 261C and submit a new fund under management application (AIFMD requirement)
<b>Supporting documents</b>	<ul style="list-style-type: none"> <li>• draft prospectus</li> <li>• draft contractual scheme deed (with solicitor's certificate)</li> <li>• model portfolio for each sub-fund</li> <li>• draft KIID</li> </ul>	Same as UCITS (though KIID optional)	Same as UCITS (though KIID not required)
<b>Timeline</b>	2 months (set by UCITS Directive) though FCA aims to approve 90% of applications within 6 weeks	6 months (under FSMA) though FCA aims to approve within 3 months (2 months from 1 April 2015)	6 months (under FSMA) though FCA aims to approve within 2 months (1 month from 1 April 2015)
<b>Application fee</b>	£2,400 for an umbrella scheme with sub-funds	£3,000 for an umbrella scheme with sub-funds	£4,800 for an umbrella scheme with sub-funds

In a typical case the FCA will nominate a dedicated case officer who will be responsible for reviewing the submitted application and working with the Operator (or typically the Operator's representative) to amend any parts of the application and documentation until they believe it meets the regulatory requirements. Once the case officer's work on the application is complete, it is passed to the team leader who will give overall approval to the application. At this point it will become an authorised scheme and will be listed on the FCA's financial services register.

The FCA may agree that the ACS application may be submitted alongside a new Operator application (if such an application needs to be submitted), though the FCA will not be able to authorise the ACS until the Operator itself has been authorised.

Once the ACS is authorised FAS will be responsible for supervising it and ensuring it operates within the regulatory requirements (for which the depositary and Operator are also responsible). In terms of supervision the ACS may be included in wider thematic reviews or more targeted "deep dives" undertaken by the FAS team. Whilst the FCA's FAS team will be supervising how the ACS acts, the onus will be on the Operator of the ACS to demonstrate how it is compliant.

An ACS Operator will also be responsible for submitting new applications to the FCA to notify a change to the scheme which requires investor notification. This could be (for example) a change in fees, change to the investment objective or strategy of a sub-fund, or change to one of the key players involved in the ACS and its sub-funds, as well as the launch of a new sub-fund.

### 3.5.2 The Operator

We set out the options regarding entity choice for the Operator of an ACS in section 5. This section 3.5.2 assumes that the decision is taken to establish a new Operator vehicle as a standalone. The Operator will need to be authorised by the FCA because it will be undertaking regulated activities as driven by the RAO. Specifically these are the activities of managing authorised AIFs because a QIS ACS will meet the requirements of being an AIF under the AIFMD. This permission would allow the Operator to carry out all activities connected with being an AIFM, including providing risk management, investment management, administration services, etc. Even if it delegates the investment management activity the Operator will still be responsible, from a regulatory perspective. The Operator will not be an investment firm under the

Markets in Financial Instruments Directive (“MiFID”) because the operators of ACS and similar schemes are exempted from MiFID (Article 3).

A new Operator will need to be authorised first by the FCA before it can launch the ACS. An Operator will also be subject to ongoing supervision by the FCA once authorised.

Under FSMA the FCA has up to six months to determine complete applications seeking authorisation for a new entity (and up to 12 months to determine incomplete applications). There is no guidance on what constitutes a complete/incomplete application. Typically in our experience most applications will be treated as being incomplete on first submission as the FCA will raise further questions about part of the application. However, it typically takes no more than six months for an application to be authorised.

The application pack to be submitted to the FCA to seek authorisation as a new AIFM is very detailed and comprehensive. It will be necessary to provide detail around the business plan of the Operator (including committees that will be established around risk management, investment and remuneration), proposed fee structures, individuals who will play a key role in running the business, the types of funds it will be operating and any other relevant information on compliance and governance within the Operator.

Key individuals within an Operator will also require approval by the FCA under its approved persons regime for controlled functions (“CF”). These may include:

- Directors (who will hold CF1)
- Non-executive directors (who will hold CF2)
- Chief executive officer (who will hold CF3)
- Head of compliance (who will hold CF10)
- CASS oversight function (who will hold CF10A)
- Money laundering reporting office (who will hold CF11)
- Investment managers (who will hold CF30)

An Operator must assess each individual as being competent to hold their role before the application is submitted to the FCA. The FCA will then approve these individuals if it believes they are fit and proper, meeting its tests in the FIT (The Fit and Proper Test for Approved Persons) and APER (Statements of Principle and Code of Practice for Approved Persons) sourcebooks. Once approved these individuals may then be held to account if the Operator fails to meet its regulatory requirements in any specific area.

Further, an Operator must submit, or have available for submission, the policies and procedures it will use in relation to compliance (including a compliance monitoring programme), conflicts of interest, remuneration and business continuity. The FCA may also require information concerning any proposed outsource arrangements and those remaining in-house which it will carry out itself. It will not expect the Operator to be a “shell” or letterbox entity – it should carry out some business activities within the Operator as well as outsourcing to other specialist providers. As an AIFM this may mean that it performs risk management activities since investment management will likely be outsourced to specialist providers. Third parties may be contracted to assist in risk management provided they are working within the Operator rather than acting as a delegate of the AIFM. We have seen a number of firms operate under this structure when implementing AIFMD into their business over the last year.

Lastly, authorised firms must meet regulatory capital requirements. For the Operator these are driven by the UCITS Directive (if the ACS is set up as a UCITS scheme) or the AIFMD (if the ACS is set up as a NURS or QIS). Under the UCITS Directive the capital requirements will be:

- EUR125,000 + 0.02% of assets under management over EUR250,000,000; or
- one quarter of fixed operating costs (whichever is higher).

For an AIFM the capital requirement calculation is the same, but is capped at a maximum of EUR10,000,000<sup>3</sup>. Additionally, the AIFM must hold either professional indemnity insurance or additional regulatory capital (0.01% of assets under management) to account for professional liability risks that the Operator faces – for example, for loss of documents or an error by an individual within the Operator.

Once authorised, the Operator will be supervised by the FCA in accordance with its assessment of the correct supervisory level to be applied. The FCA will supervise the Operator both from a prudential and a conduct perspective. Depending on the level of supervision considered appropriate, the Operator may have a relationship supervisor appointed who is responsible for the regulatory supervision of the Operator. In this situation it is likely to have more frequent contact with the FCA and be monitored more closely to ensure it is operating within the FCA's rules and expectations.

If no direct supervisor is allocated then the Operator may well have more infrequent contact with the FCA – though could still be included in any thematic reviews or ongoing supervision work that reviews specific parts of the business and how it operates on a daily basis.

## 3.6 Legal considerations

### 3.6.1 ACS Structure

Under the ACS Regulations, there are certain pre-requisites about the structure of an ACS which need to be observed. As mentioned above, an ACS can take two forms: a "co-ownership scheme" or a "partnership scheme". Principally because of the fact that a limited partnership cannot have an umbrella structure (but would require multiple partnerships to offer LGPS Funds sub-funds for investment) and restrictions over the extent to which limited partners can become involved in any form of management of a limited partnership, we have disregarded the second of these structures.

A co-ownership scheme is defined under Section 235A FSMA as a CIS which satisfies certain conditions:

- the arrangements are contractual;
- they are set out in a deed between the operator and the depositary which itself contains certain prescribed provisions (see below);
- the scheme itself does not constitute a body corporate, partnership or limited partnership;
- the property subject to the scheme is held by or to the order of a depositary; and
- the property is owned beneficially by the participants as tenants in common.

What this means is that the ACS itself has no legal personality (if it were to be a separate person, that would undermine its tax transparency). Instead, the legal owner of the property is the depositary (i.e. a custodian in more common parlance), where the participants (or investors) are the beneficial owners of the underlying property. Here those participants would be the LGPS Funds.

The legislation requires the operator to act as the manager of the ACS. Because the scheme is a CIS within the meaning of Section 235 FSMA, that person must be authorised to operate (as well as establish and wind up) an ACS. Note that this activity of management is not the same as the separate authorised activity of managing investments under the RAO.

By virtue of section 261D FSMA, the operator and depositary must be:

- independent of each other;
- each "a body corporate incorporated in the United Kingdom or another EEA State";
- each have a place of business in the UK or another EEA State, and
- each a "fit and proper person".

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<sup>3</sup> These amounts are expressed in Euro because they are provided for in European directives but they can be held by the entity in the GBP equivalent of this amount.

The last requirement refers to a general prudential requirement under FSMA for authorised persons, the test for which is set out in detail under the FIT under the High Level Standards part of the FCA Handbook. The detailed operational rules of an ACS are set out in the FCA's Collective investment schemes sourcebook ("COLL").

These financial services regulatory requirements will have a bearing on the optimum choice of the ACS Operator; on this subject see section 5 below.

### *3.6.2 LGPS investor status*

As explained above, LGPS Funds which are invested through an ACS would retain beneficial ownership of the underlying property which was held subject to the scheme. However, as the LGPS Funds would hold property as tenants in common, no individual LGPS Fund would be able to claim that it owned any particular assets. This would not be a practical problem in respect of listed assets, which would, by definition, all have the same characteristics, but it would be an issue in relation to certain alternative investments, which are not divisible in the same way. Real estate in particular is a good example of where this would be a practical problem.

This issue of legal ownership of an ACS' underlying assets may also impact the ability of an ACS to provide a liability driven investment ("LDI") sub-fund. The reason for this is that bank counterparties to derivatives transactions which an LDI sub-fund would use would require there to be a clear and unfettered right of ownership over assets posted as collateral in respect of such transactions. Unlike some other forms of pooled arrangement where the bank's counterparty (such as a life company, unit trust or OEIC) has sole legal title to the collateral assets, this would not be true of an ACS (or, for that matter, a limited partnership). It is outside the scope of this Report to design a solution to this problem, but it may mean that the relatively small number of existing LDI strategies that have been adopted by LGPS Funds to date would have to remain outside any collective vehicle. We understand that one LGPS Fund, Berkshire Pension Fund, has entered into a longevity swap arrangement with Swiss Re. Given the bespoke nature of this arrangement we have not considered whether it is possible to transition this to an ACS.

The ACS Regulations make provision for the unitisation of the interests of participants. Participating LGPS Funds would have their rights set out in relation to the issue and redemption of units in the deed establishing the ACS. The ACS Regulations are permissive in either allowing the deed to prohibit the transfer of units or to allow for units to be transferred only if specified conditions are met. They also permit different policies to be adopted in relation to different sub-funds so that, as with other forms of collective investment scheme, different rights (and therefore different pricing- see below) can be established in relation to different sub-funds.

The ACS Regulations contain unit pricing rules in Section 261E (reflected in COLL 6.3). These provisions include the fact that units may not be issued to anyone other than a professional investor, a large investor or a person who already holds units in the scheme. (See above, section 3.1).

The rights of unit holders are not prescribed in any detail by legislation or by COLL, although COLL 4.4 sets out numerous requirements for the conduct of investor relations. Given the importance of establishing appropriate governance arrangements for the proposed ACS (see section 4 below), the following are the most relevant provisions.

In the case of an ACS, it is the depositary which has the power to convene a general meeting of unit holders, although as with a corporate entity, the unit holders may also request a general meeting (COLL 4.4.2). There is no de minimis limit on the number of units that must be represented by unit holders calling for such a meeting, hence this can be prescribed in the ACS deed.

COLL 4.4.10 also allows unit holders in the ACS to appoint proxies. Through this mechanism, oversight entities could be appointed as proxy for the participating LGPS Funds, to avoid the logistical problem of a large number of separate votes on any poll of unit holders i.e. corresponding to the participating LGPS Funds.

However, there are restrictions on what unit holders can and cannot do. In keeping with the more stringent provisions which apply to limited partnerships, it is a statutory function of the operator alone to:

- acquire, manage and dispose of properties subject to the scheme; and
- enter into contracts which are binding on participants for the purposes of, or in connection with, the acquisition, management or disposal of property subject to the scheme.

Any contracts which are entered into in respect of the statutory function of the operator are referred to as "authorised contracts" under Section 261M of FSMA. The operator has consequential obligations to:

- exercise rights under an authorised contract;
- bring and defend proceedings for the resolution of any matter relating to an authorised contract; and
- take action in relation to the enforcement of any judgment given in such proceedings. (Section 261M(3)).

The fact that the unit holders in the ACS may not themselves do any of these things does not affect their rights against the operator, who effectively acts as their agent.

### *3.6.3 Liability of unit holders, operator and depositary*

As in a limited partnership, unit holders in an ACS are expressly provided with limited liability by virtue of Section 261D of FSMA, which states that "the participants in a relevant scheme are not liable for the debts of the relevant scheme beyond the amount of the property subject to the relevant scheme which is available to the operator to meet the debts". Unlike a limited partnership, however, there is no reference to the loss of this limited liability if the participants were to become involved in management on a day to day basis of the affairs of the ACS.

In keeping with provisions which are made under the AIFMD, Section 261T FSMA states that any provision in an ACS deed is void if it would have the effect of exempting the operator or the depositary from any liability "for failure to exercise due care and diligence in the discharge of its functions in respect of the scheme". To that extent, liability is therefore strict on the part of both the operator and the depositary.

The segregation of liability in relation to sub-funds under an umbrella ACS is provided for by Section 261P FSMA, which states that the "property subject to a sub-scheme of an umbrella co-ownership scheme must not be used to discharge any liabilities of, or meet any claims against, any person other than the participants in that sub-scheme". This would achieve the goal of ensuring that there was no unintended cross-subsidisation of liabilities between sub-funds (and therefore between different participating LGPS Funds).

# 4. Governance

## 4.1 Separating operator and oversight functions

We set out here one approach to separating the operational and oversight functions in a practical way. This is by no means the only way of achieving this separation, so it is described only to provide an example of an approach which is consistent with the legal requirements. Other approaches would also be possible.

The Operator would be responsible for delivering investment returns within an ACS structure. To this end, its key functions would be to establish sub-funds, and to appoint, manage and dismiss investment managers to operate the sub-funds. It would also need to engage with the participating LGPS Funds through its own customer function and the administrator and could provide performance statistics on the sub-funds. It would be authorised by the FCA. Roles are described more fully below.

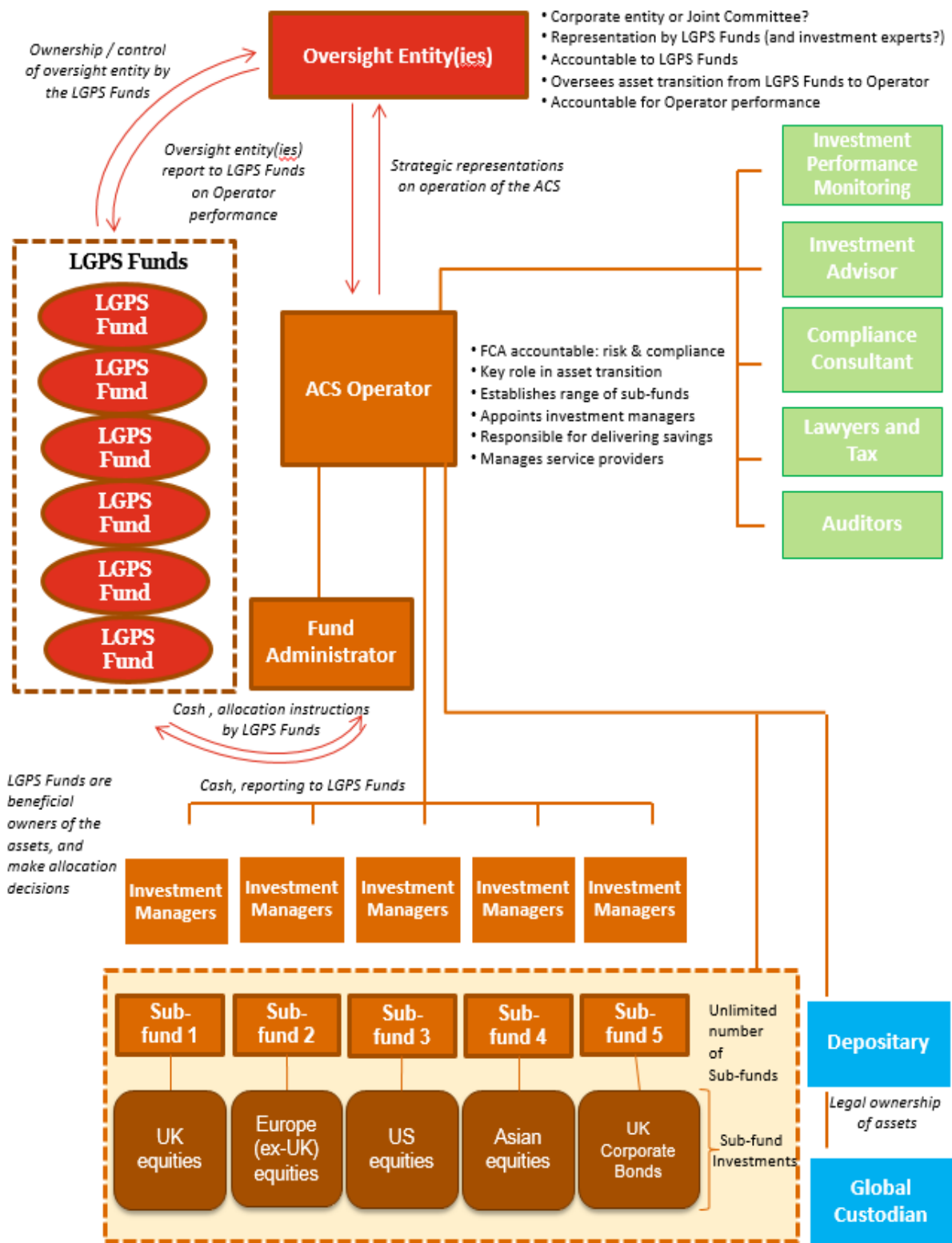
Oversight could then be by a separate entity or entities, essentially non-executive in nature, which would be accountable to the participating LGPS Funds for the performance of the Operator. The functions of any oversight entities would be carefully defined so that they were not effectively operating the ACS, since this would involve carrying on a regulated activity and require it or them to be authorised by the FCA.

### 4.1.1 Benefits of separating the operator and oversight functions

The primary benefits of the separation of the operator and oversight functions are:

- As unregulated bodies, oversight entities could bring a wide range of experience and perspectives to the oversight role. The oversight entities would provide appropriate and efficient mechanisms to challenge the Operator. This would supplement the regulatory oversight of Operators by the FCA.
- The participating LGPS Funds can be properly represented, channelling their voices through their agreed oversight entities. Representation might work in various ways, reflecting the greater constraints of working efficiently if there are higher numbers of participating LGPS Funds working with a given Operator.
- The participating LGPS Funds would have a keen interest in the performance of the sub-funds but not direct authority over their management.
- Separation enables the appointment of strong investment teams at Operators, which would be FCA regulated. The best professionals employed here should be able to focus on meeting the challenge of delivering investment savings and long term investment performance, at scale, in each asset class that it offers.
- The ability, if it were to be set up as a new body, to build a bespoke Operator that could be designed to meet the precise investment needs of the participating Funds





## 4.2 Oversight entities

An oversight entity could take several different forms. It might be a Joint Committee or a corporate entity or a group constituted in some other way to suit the needs and objectives of the participating LGPS Funds. It might be a single entity or a combination of several entities.

For simplicity, an entity rather than entities is described below. This should be taken to include a combination of entities to suit participating LGPS Funds' specific requirements of a given CIV.

### 4.2.1 Roles and responsibilities of oversight entities

- During the set up phase\* of an ACS, if a private sector provider is to be procured to deliver the Operator function, the oversight entity could appoint the provider;
- During the transition phase to the ACS, the oversight entity would be accountable to the participating LGPS Funds for the execution of transition plans;
- During the operate phase, the oversight entity could collate and evaluate participating LGPS Fund requests for additional investment sub-funds;
- The oversight entity could be the forum for aggregation of regular Operator and sub-fund information, performance and other analysis, preparing this for dissemination to the participating LGPS Funds;
- The oversight entity could ensure that participating LGPS Funds had sufficient information on sub-Funds to enable the LGPS Funds to make informed decisions about asset allocation, subject to proper advisory processes;
- Oversight entities could carry out performance bench-marking between different ACSs / other pooled arrangements and best practice sharing; and
- Oversight entities could make recommendations on behalf of participating LGPS Funds to the Operator in relation to the operation of the ACS.

\*These observations assume that the phases of establishing an ACS would be broadly as follows:



### 4.2.2 Composition of an oversight entity

One practical structure for an oversight entity might involve one member from each participating LGPS Fund, perhaps the Chair of a Pensions Committee or a Head of Fund. There may be value in different Funds nominating people with different roles, to achieve a mixture of expertise on the oversight entity.

There might also be appointments with investment industry expertise.

Individuals involved in oversight entities would not require FCA authorisation for this role.

### 4.2.3 Representation by participating LGPS Funds.

Participating LGPS Funds for a given CIV may vary in size and representation might, to some extent, reflect asset value (or membership numbers, if broadly the same thing) if the variation was very significant. It would however be essential to ensure that the smallest LGPS Funds are fully represented.



Other factors to consider include: -

- **Capturing knowledge.** A number of LGPS Funds have been managed internally with success (source: State Street Investment Analytics, September 2013 report). The London Borough LGPS Funds have been establishing a CIV on a voluntary basis. There are proposals between geographically separate LGPS Funds to work together, such as between the LPFA and Lancashire. Frameworks and shared procurements are in use. The knowledge underpinning these situations should be captured by any oversight entity.
- **Political balance.** The existing Pension Committees of the LGPS Funds reflect the political composition of local councils (as required by wider local government law: Local Government and Housing Act 1989 s15). There may be a wish to have balanced representation by major political parties in some oversight entities, although within a separate corporate vehicle this would not be required. Similarly, there may be a place for union representation, but again this would not be required.
- **Operational and investment expertise.** It may be helpful if some of an oversight entity's members were to have direct investment experience, gained either within or outside the LGPS and a mix of experience might be considered the most desirable.
- **Continuity of membership.** A long term view of investment issues has often been identified as a basis for investment success. The impact on continuity should be considered when rights to appoint and remove members were decided.
- **Infrastructure investment.** Our scope in this report is limited to ACSs for listed investments. If CIVs include unlisted investments, such as infrastructure or private equity, membership of oversight entities should reflect this.

An oversight entity's individual members could be in a visible and responsible role. There may be an analogy between their position and those of existing members of LGPS Funds' pension committees, but the scale of an ACS could be substantially larger, and there will be a high degree of public scrutiny.

It may be important that the individual members of an oversight entity are not delegates of any statutory functions of the participating LGPS Funds, since that could cut across the decision that asset allocation should remain local.

#### *4.2.4 Legal structure*

There are no particular restrictions on the form an oversight entity can take, since we do not believe their functions would amount to a "commercial purpose" within section 4 of the Localism Act 2011 (which requires local authorities engaged in such purposes to act through a company).

One possibility is that an oversight entity is established as a company limited by guarantee in relation to which each of the participating LGPS Funds would undertake responsibility for a nominal amount (usually £1) of the oversight entity's debts, should any arise on its winding-up. This structure has the benefit of providing participating LGPS Funds with limited liability in relation to the oversight entity and the ability to establish a bespoke governance process within a distinct and separate corporate structure.

Alternatively, an oversight entity could be structured as a joint committee under section 102 of the Local Government Act 1972. Although the political balance requirements apply to pensions committees by virtue of Section 15 of the Local Government and Housing Act 1989 and schedule 1, para 1(e), (detailed in Appendix 3, section 3.2 of this Report) the delegation of functions to a joint committee deems the political balance requirement to be satisfied already for each participating authority.

## **4.3 The Operator**

### **4.3.1 Roles and Responsibilities of the Operator**

The Operator of an ACS would: -

- set up and manage service providers (depository, administrator, investment managers etc.);
- set up the agreed initial range of sub-funds;
- during the transition phase, manage one side of the transition of assets from participating LGPS Funds to the Operator;
- carry out the ongoing management of the ACS;
- be accountable to the FCA and to oversight entities, and through them, to the participating LGPS Funds;
- manage relationships with participating LGPS Funds as customers;
- set up new sub-funds itself or through appointed third parties;
- oversee investment management performance; and
- provide information analysis and reporting.

The Operator would also make many of the key decisions, notably around:

- appointment and removal of investment managers;
- management;
- risk and compliance; and
- legal rights to bring / defend proceedings.

### **4.3.2 Board Composition**

The composition of an Operator's board is likely to depend on the operational structure adopted for the Operator. These structures are described in more detail in section 5.

Option A: Set up – the board will be designed and appointed by the participating LGPS Funds.

Option B: Appoint – the commercial provider may have an existing board in place for the Operator.

### **4.3.3 Operator legal structure**

This will depend on the set up option taken forward (set up or appoint). See section 5 for a discussion.

## **4.4 Administrative interactions between the LGPS Funds and the Operator**

Day to day interaction between the participating LGPS Funds and the Operator would be through the Administrator, which would be responsible for cash transactions to and from the LGPS Funds. The LGPS Funds would instruct the Administrator as to asset allocations between sub-funds, and the Administrator would report holdings and other information to the LGPS Funds.

A detailed model of Operator / participating LGPS Funds interactions would be required in each case.

It is, however, possible to start identifying opportunities that an ACS may offer to improve LGPS Fund operation, governance and transparency. Examples may include:

- If the ACS Administrator engaged by the Operator were able to report several separate holdings in each ACS sub-fund to each participating LGPS Fund, it would provide a simple mechanism to enable individual LGPS Funds to offer different investment strategies to different employers or groups of employers.
- Any performance monitoring service engaged by the Operator could be charged with delivering clear information about the initial and changing characteristics of each sub-fund to reduce participating LGPS Funds' investment advisor costs and minimise reporting duplication.
- The performance monitoring service may be charged with delivering combined analysis on each LGPS Fund performance within the ACS, to permit clear differentiation between sub-fund performance effects and asset allocation performance effects.

As explained in section 3.6.2, certain investment functions must be carried out by the Operator. Notably, there will be restrictions on rights of the LGPS Funds as investors regarding “authorised contracts” (i.e. contracts relating to acquisition, management and disposal of ACS property). The LGPS Funds would not be able to bring or defend proceedings or take action to enforce a judgment. All of these functions must be carried out by the manager or depositary appointed by the Operator.

#### *4.4.1 Management by LGPS Funds of their investments in a CIV*

The process of establishing pooled funds / CIVs / ACSs by groups of LGPS Funds is outside the scope of this report. However, during the establishment and then in operation, it will be essential that participating LGPS Funds anticipate and then understand how new arrangements will impact the way they operate.

We understand that the overall investment performance of each of participating LGPS Fund would typically remain the responsibility of its local pension committee and of great importance to its local pensions advisory board.

It is widely understood that overall investment performance of any major pension fund is driven much more by allocation decisions between classes of asset than by the performance of individual investment managers within each asset class. It would be important to ensure that this position is not undermined for participating LGPS Funds by poor performance of individual sub-funds in their CIV.

The performance of the sub-funds run by the Operator would typically be judged against investment industry benchmarks for the specific relevant asset classes. These performances would be elements of, but distinct from the overall investment performance of each of the participating LGPS Funds, since they would each retain the authority to make asset allocation decisions.

The practical work required by LGPS Funds to manage investments at the local level would be reduced by the introduction of the CIV. This should allow more efficient use of officer, committee and pension board time.

The broad nature of the work that may be required by each participating LGPS Fund could include the following:

- Facilitating the transition of assets into its CIV in line with any revised investment regulations and processes to be established.

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- Finding a route to permit gilts to be retained as collateral against existing or envisaged derivative contracts for an LDI sub-fund.
  - Reviewing the extent of any investments which would not be held within the CIV.
  - Establishing and maintaining understanding about the risk, return, income generation and liquidity characteristics of each of the sub-funds in which the LGPS Fund wishes to remain invested or make new investment.
  - Transitioning to a revised investment strategy that recognised the characteristics of:
    - that individual LGPS Fund, typically including liability profile, deficit, employer covenants, and affordability of contributions and trends in contributions;
    - the sub-funds to be held; and
    - any separately held illiquid assets and derivative contracts.
  - Documenting the revised investment strategy in the individual LGPS Fund's Statement of Investment Principles.

Once through transition, there should be reduced requirements for investment advice to the LGPS Funds, in particular removing processes to directly appoint and monitor investment managers for listed assets. There would remain a need for investment advice to inform the decisions and actions identified above.

# 5. Operational structure

There are two main potential delivery models for the Operator of a CIV: build / set up or buy / rent. Each of these options is set out below with an analysis of the criteria for decision-making. This is not intended as an exhaustive list: participating LGPS Funds in a CIV will have further criteria to be factored into the decision-making process.

Buying / renting an Operator could include the use of a fiduciary investment service.

Given that setting up / building an Operator is more time consuming, this may be an option that CIVs plan to move to, having started by buying / renting the Operator service.

## 5.1 Operational structure options

### 5.1.1 Option A: set up Operator

- **Cost:** this may be the more expensive delivery model to implement. It may involve IT, with systems procurement, design and build. An Operator built from scratch requires all processes and policies to be developed during a set up period in order to prepare for FCA authorisation. There may be recruitment costs for a new team unless roles could be filled by alternative resourcing models e.g. secondments / transfers from participating LGPS where existing staff matched requirements in the new operator. Further costs include procurement of the depositary/global custodian, administrator and transfer agent as well as programme management throughout the lifecycle of the set up project.
- **Capital requirement:** the participating Funds would need to provide this.
- **Implementation timeframe:** this is estimated at up to 18 months to FCA authorisation for the ACS and operator. This assumes a 12 month set-up period followed by a 6 month FCA authorisation process. There is now some experience of setting up Operators for LGPS CIVs, which may help reduce the 12 month projected timeframe for set-up, but the challenge involved in establishing Operator processes clearly enough for an FCA application should not be underestimated.
- **Onward procurement (depositary, administrator, investment managers):** in this model, Public Contracts Regulations 2006 (“PCR”)<sup>4</sup> are likely to apply in full as an administering authority owned Operator will be considered a contracting authority. As such, the OJEU procurement process must be followed. The exemption in Regulation 6 (2)(h)<sup>5</sup>, considered in Appendix 3, only applies to public bodies who are investors so will not apply. It will not be possible for the Operator to access existing LGPS framework agreements for the appointment of investment consultants, auditors, legal advisors or custody services on behalf of all LGPS Funds since the terms of those frameworks are clear that they are open only to LGPS Funds (or rather their administering authorities) and, in the case of the custody framework, certain other designated public bodies such as the Pensions Protection Fund. As such they would not be accessible to the Operator of an ACS, which by definition would be a new body and which was not in existence at the time when the various frameworks were procured.
- **Value for Money:** All procurement is subject to public sector value for money (“VFM”) tests.
- **Staff:** Some new recruits would come from the asset management industry in order to meet FCA requirements. This creates an issue for new Operators in that they would be seeking to attract a talent pool into the public sector at potentially lower levels of pay than offered by their home industry.

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<sup>4</sup> Now Public Contracts Regulations 2015 (“PCR2015”)

<sup>5</sup> Now PCR2015, Regulation 10(1)(e)(i)

- Managing investment managers: The participating LGPS Funds will have oversight of manager performance through their oversight entity(ies).
- Engagement by LGPS Funds: this model may create higher engagement with participating LGPS Funds by involving existing investment teams through secondments or transfers. Operators could develop a regional presence reflecting the broad location of the participating Funds. Operators could also set up a customer/stakeholder team to manage relationships with individual LGPS Fund and provide regular reporting to them. Any operational service issues and improvements could be handled through this communication route.

### 5.1.2 Option B: appoint operator

- This may be the lower cost delivery option. Establishment costs would involve a detailed operating model design to develop requirements for the ITT for the Operator. There would also be costs for procurement and programme management. The Operator would normally procure the depositary/custodian, administrator and transfer agent. Systems would typically be provided by the Operator, included within its charging structure.
- Participating Funds would normally assume that their Operator's costs will be passed back to them in set up fees and ongoing contractual payments. The scale of these costs would depend on many factors including the extent to which the Operator could reuse existing systems, configurations required, number of sub-Funds, and total assets under management. Negotiations may be appropriate to smooth costs over the projected life of the contract etc.
- Capital requirement: The appointed Operator would normally provide the capital required for FCA authorisation within its fee structure.
- Implementation timeframe: appointing the operator is the fastest implementation route for the ACS as the operator will have existing systems, people, processes and policies which can be tailored to fit the purpose of the LGPS ACS. We estimate 9 months to FCA authorisation including development of a high-level operating model in parallel with a consultation process and regulatory changes, followed by immediate launch of a procurement process to select the Operator. The FCA authorisation process for the ACS could start soon after the Operator is appointed. The Operator itself may have already achieved ACS authorisation.
- Onward procurement (depositary, administrator, investment managers): in this model, PCR should not apply to the procurement of the depositary/global custodian, administrator, transfer agent, investment managers if they are appointed by the Operator.
- Value for Money: to ensure that the Operator works to the VFM test, contractual terms could be set by the oversight entities to include the VFM test. These could also be passed on to sub-contractors.
- Staff: Existing teams with FCA authorisation would be used to staff the Operator so FCA approval may be quicker. Staff in the asset management sector would be able to leverage existing relationships with service providers and investment managers, creating potential for a smoother start-up phase.
- Managing investment managers: there is a requirement that the Operator and depositary of an ACS are independent of each other (section 261D(4)FSMA). There is no express prohibition on an ACS operator connected investment managers to manage the underlying assets (indeed some of the several ACS that we anticipate will be marketed use precisely this model.
- Concerns about the avoidance of conflicts of interest between the operator and the manager(s) would have to be addressed in the way in which the ACS operator was initially procured itself, for instance by specifying that all onward procurements would be made on arm's length terms. FCA rules would to some extent mitigate the risk of conflicts of interest that apply to all authorised firms.
- Engagement by LGPS Funds: this model may have a lower potential for engagement with LGPS Funds as there is less capacity for existing investment teams to join the Operator delivery team.

### 5.1.3 Prioritising selection criteria

Ultimately, the choice of delivery model for any given CIV will depend on the priority given to the criteria above and others developed internally by participating LGPS Funds.

Appointing an Operator may be the faster and the lower cost route to setting up a CIV. However, its success will rely on a successful commercial negotiation of contracts on set up, partnership working and rigorous change management during the life of the deal in order to avoid excessive costs for unforeseen events in the medium- to long-term. Planning for later transition to a build model may also be important.

## 5.2 Operational set-up

The key processes that participating LGPS Funds will need to undertake to build / set up or buy / rent an Operator are likely to be:

	<b>Build / Set up</b>	<b>Buy / Rent</b>
<b>Legal Structure</b>		
<b>Operator &amp; oversight entities – corporate structure, set up &amp; governance</b>	✓	✓
<b>ACS scheme deed</b>	✓	✓
<b>Design</b>		
<b>High-level operating model design</b>	✓	✓
<b>Detailed operating model design</b>	✓	✓
<b>Business process design</b>	✓	
<b>Organisational design</b>	✓	
<b>Governance, risk &amp; compliance design</b>	✓	
<b>Build</b>		
<b>IT systems</b>		
- Risk	✓	
- Portfolio Management	✓	
- Finance & HR	✓	
- CRM	✓	
- MI & reporting	✓	
<b>Non IT</b>	✓	✓
- <b>Programme Management</b>		
- <b>Procurement</b>	✓	
o Administrator		
o Depositary/global custodian		
o Transfer agent		
<b>Recruitment</b>	✓	
<b>FCA authorisation</b>		
- ACS	✓	✓
- Operator	✓	





# Appendix 1

## Glossary

ACD	Authorised corporate director
ACS	Authorised Contractual Scheme
ACS Regulations	Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013 (SI 2013/1388)
AFM	Authorised fund manager
AIF	Alternative investment fund
AIFM	Alternative investment fund manager meeting the requirements of the AIFMD
AIFMD	Alternative Investment Fund Managers Directive (Directive 2011/61/EU)
APER	Statements of Principle and Code of Practice for Approved Persons
AUT	Authorised Unit Trust
Award Letter	Agreement entered into between Cabinet Office and PwC, signed and dated 4 <sup>th</sup> December 2014, instructing PwC in relation to the production of this report.
CCF	Common Contractual Fund – an Irish fund type
CCO	Chief Compliance Officer
CEO	Chief Executive Officer
CF	Controlled Functions as described by the FCA: <a href="http://www.fca.org.uk/firms/being-regulated/approved/approved-persons/functions">http://www.fca.org.uk/firms/being-regulated/approved/approved-persons/functions</a>
CFO	Chief Financial Officer
CIO	Chief Investment Officer
CIS	Collective Investment Scheme
CIV	Collective Investment Vehicle
COLL	FCA’s Collective Investment Schemes sourcebook
Consultation	“Local Government Pension Scheme: Opportunity for collaboration, cost savings and efficiencies” <a href="https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307923/Consultation_LGPS_structural_reform.pdf">https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307923/Consultation_LGPS_structural_reform.pdf</a>
COO	Chief Operating Officer
CRM	Customer Relationship Management
DCLG	Department for Communities and Local Government

December 2013 Report	Hymans Robertson report of December 2013 ( <i>LGPS structure analysis</i> )
EEA	European Economic Area
EUR	Euro currency
FAS	FCA's Fund Authorisation and Supervision team
FCA	Financial Conduct Authority
FCP	Fonds Commun de Placement – a Luxembourg fund type
FIT	Fit and Proper Test for Approved Persons
FSMA	Financial Services and Markets Act 2000, as amended
FTSE	Financial Times Stock Exchange
GBP	Pounds Sterling currency
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
HR	Human Resources
IORP	Institutions for Occupational Retirement Provision Directive (Directive 2003/41/EC)
IT	Information Technology
ITT	Invitation to tender
KIID	Key Investor Information Document
LDI	Liability driven investments
LGA	Local Government Act 1972
LGHA	Local Government and Housing Act 1989
LGPIHA	Local Government and Public Involvement in Health Act 2007
LGPS	Local Government Pension Scheme in England and Wales
LGPS Funds	The existing 89 Funds of the LGPS; participating LGPS Funds refers to those LGPS Funds that participate in a given CIV or ACS
LP	Limited Partnership
LPFA	London Pensions Fund Authority
MI	Management Information
MiFID	Markets in Financial Instruments Directive (Directive 2004/39/EC)
NED	Non-Executive Director
NURS	Non-UCITS Retail Scheme
OBC	Outline Business Case
Oversight entities	Entities established by participating LPS Funds to oversee and monitor pooled vehicles / CIVs / ACSs. Oversight entities may take a range of forms.

OEIC	Open-ended investment company
OEIC Regulations	Open-ended Investment Company Regulations 2001
OJEU	Official Journal of the European Union
OTC	Over the counter, i.e. OTC Derivative
PCR	Public Contracts Regulation 2006
PSPA	Public Service Pensions Act 2013
PwC	PricewaterhouseCoopers LLP
QIS	Qualified Investor Scheme
RAO	The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, as amended
Report	This report on the design of the structure and governance of efficient and effective CIVs for LGPS Funds
S&P	Standard and Poor's
SAB	Scheme Advisory Board
SDLT	Stamp Duty Land Tax
SDRT	Stamp Duty Reserve Tax
SPB	Squire Patton Boggs (UK) LLP
UCITS	Undertaking for Collective Investment in Transferable Securities as defined in the UCITS Directive (Directive 2001/107/EC and 2001/108/EC)
UCITS Management Company	Fund management company meeting the requirements of the UCITS Directive (Directive 2001/107/EC and 2001/108/EC)
UK	United Kingdom
VAT	Value added tax
VFM	Value for money

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# Appendix 2

## 1. UCITS schemes

A UCITS scheme is one which meets the requirements set out in the UCITS Directive. It can broadly invest in transferable securities (such as shares and bonds), other collective investment schemes, deposits, derivatives and money market instruments. It cannot invest in other alternative assets such as commodities or real property, although it may gain exposure to these asset classes indirectly. One of the key requirements of a UCITS scheme is that it raises money from the public. Funds can, however, set their own minimum investment limits which might prevent most investors from investing into the fund. In fact, an ACS must impose minimum investment limits of £1m to keep small retail investors from accessing the scheme. Given the basic requirement for the UCITS to be widely available and the need to set additional investment conditions to artificially restrict the investor base, the UCITS is considered unattractive.

It is also a key requirement of the UCITS Directive (and implemented in the FCA rules in COLL) that a UCITS scheme cannot be converted into a NURS or a QIS (COLL 3.2.8R).

The UCITS rules are prescriptive concerning funds that seek actively to replicate an index (by investing in the underlying components of an index). The rules allow some of the specific UCITS spread rules to be amended so that a UCITS can invest up to 20% of its scheme property into a single entity because that reflects the entity's relationship to the index. This can be increased to 35% of property in exceptional circumstances (note this would apply at each sub-fund level rather than across the ACS as a whole).

## 2 NURS

Similarly to the QIS, the NURS falls within the definition of an AIF under the AIFMD.

A NURS is a UK-specific scheme type. It can invest in broadly the same types of assets as a UCITS but can also invest in gold (up to 10% of scheme property) and real property. It also has more relaxed concentration and spread limits than a UCITS scheme. The NURS rules for directly tracking an index are similar to those of a UCITS, though the rules are more flexible on the types of index a NURS can track. Both a UCITS and NURS would be able to track a normal equity index like FTSE 100/250, S&P 500 etc.

### 3. Comparison between the UCITS, NURS and QIS schemes

Investment classes	UCITS restrictions (assumed the scheme is not a feeder fund)	NURS restrictions (assumed the scheme is not a feeder fund)	QIS restrictions
<b>Spread requirements</b>	Must ensure that the fund delivers a spread of risk in line with its objective and policy within six months of launch	Must ensure that the fund delivers a spread of risk in line with its objective and policy within 12 months of launch/end of initial offer period (except spread rules for immovable property, which apply after 24 months)	Must take reasonable steps to provide a spread of risk in line with the fund's investment objective and policy
<b>Eligible assets</b>	Transferable securities (including shares and bonds), regulated collective investment schemes, warrants, investment trusts, deposits, derivatives and money market instruments	Same as UCITS but can also invest in unregulated collective investment schemes, gold and immovable property	Any specified investment listed in the RAO as well as precious metals and immovable property
<b>Concentration rules</b>	Alongside the general investment limits UCITS must also not acquire more than 10% of a body corporate's shares, no more than 25% of the units in a collective investment scheme and no more than 10% of money market instruments form a single issuer	NURS do not have concentration rules but do have the detailed spread rules that they must adhere to	No specific concentration rules

<b>Index-tracking specific rules</b>	Specific spread rules for funds replicating an index that go over and above the ordinary spread and concentration rules. These allow a fund to invest up to 35% in one other entity where this is justified by exceptional market conditions. Rules also contain specific requirements about identifying eligible indices	Same spread rules as for UCITS schemes apply – only difference relates to eligible indices (rules more flexible than UCITS requirements)	No specific spread rules for tracking indices
<b>Regulated collective investment schemes (those authorised in the UK or passported from EU Member States) – other than QIS</b>	Can invest up to 100% of scheme property in other collective investment schemes (“second schemes”) – up to a maximum of 20% of scheme property in each second scheme. The second schemes themselves must only invest in UCITS eligible assets (e.g. a UCITS can invest in NURS as long as that NURS does not invest in gold or property) and must restrict their own investment into second schemes to a maximum of 10% of their scheme property. UCITS can only invest up to 30% of their scheme property in eligible schemes that are non-UCITS.	Can invest up to 100% of scheme property in second schemes – up to a maximum of 35% of scheme property in each second scheme. The second schemes themselves must restrict their own investment in second schemes to 15% of their scheme property. The second scheme must be a UCITS, NURS or fund from outside the UK with the same/more restrictive investment powers as a NURS.	Can invest up to 100% of scheme property in other regulated collective investment schemes
<b>Unregulated collective investment schemes (e.g. hedge funds) and QIS</b>	UCITS cannot invest in unregulated schemes.	Can invest up to 20% in unregulated schemes (e.g. hedge funds) – although this limit must be aggregated with any investment in transferable securities that are not approved securities.	Can invest up to 100% of scheme property in unregulated schemes as long as the authorised fund manager has first performed due diligence on the second scheme

<b>Closed-ended funds</b>	Can invest in closed-ended funds – as long as these investments are considered eligible transferable securities – cannot invest in them as collective investment schemes (for example the UCITS can invest up to 100% in investment trusts – subject to the usual spread limits).	Can invest in closed-ended funds as transferable securities or collective investment schemes (whichever criteria they meet). If not considered as approved transferable securities then investment limited to 20% of scheme property.	No specific restrictions for investing in closed-ended funds
<b>Approved transferable securities (e.g. shares and bonds)</b>	Can invest up to 100% (limited to max of 10% of scheme property invested in any single group of companies) in “approved securities” (simply put, these are securities listed on eligible markets).	Can invest up to 100% of scheme property in approved transferable securities (limited to maximum of 10% in scheme property invested in the securities of a single body (except for regulated covered bonds, where this is increased to 25% of scheme property).	No restrictions
<b>Transferable securities that are not “approved” (sometimes known as the “trash bucket”)</b>	Can invest up to 10% in securities that are not “approved securities”.	Can invest up to 20% in securities that are not “approved securities” – aggregated with the 20% investment limit in unregulated schemes.	No restrictions
<b>Derivatives</b>	Can be used for efficient portfolio management and investment purposes.	Can be used for efficient portfolio management and investment purposes.	Can be used for efficient portfolio management and investment purposes
<b>Gold</b>	Cannot invest in gold – though can get exposure to commodities through exchange-traded commodities or the securities of commodities companies.	Up to 10% of scheme property can be invested in gold – cannot invest directly in other precious metals	Up to 100% of scheme property can be invested in all precious metals

<b>Immovables (e.g. property)</b>	Cannot invest in direct property – though can invest in the securities of property companies and in real estate investment trusts (REITs).	Can invest directly in property.	Can invest directly in property
<b>Securities lending</b>	Up to 100% of scheme property can be part of securities lending transactions – subject to collateral requirements.	Up to 100% of scheme property can be part of securities lending transactions – subject to collateral requirements.	Up to 100% of scheme property can be part of securities lending transactions – subject to collateral requirements
<b>Borrowing</b>	Up to 10% of scheme property – on temporary basis.	Up to 10% of scheme property.	No limits



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# Appendix 3

## **Legal issues: investment regulations, procurement law and the establishment and ownership of oversight entities**

### **1. High-level legal considerations**

- ACS structure can be used by LGPS Funds, but the LGPS Investment Regulations may need to be amended, in particular the limits on investments in partnerships, in certain types of collective investment schemes and certain categories of defined investments.<sup>6</sup> Procurement rules would ordinarily apply to the contract with the ACS operator but under the exemption for investment in financial services in PCR 6(2)(h) <sup>7</sup>may be avoided.
- The oversight entity could take the form of a company (limited by guarantee) or a joint committee structure.
- Functions can be delegated to the oversight entity but if asset allocation is to remain with LGPS Funds, delegation may be limited.

### **2. Status of ACS under the LGPS Investment Regulations**

The power of investment which is applicable to LGPS funds is vested solely in the administering authority by virtue of Regulation 11(3) of the LGPS Investment Regulations: "*The authority must invest, in accordance with its investment policy, any fund money that is not needed immediately to make payments from the fund*". Regulation 11(4) goes on to say that the authority may vary its investments (only subject to the limits which are imposed by virtue of Regulation 14 and Schedule 1). As such, no other party (including the Secretary of State for DCLG as the responsible authority for the LGPS) has the power to direct how investments may be made.

Because it is intended that asset allocation decisions will be reserved expressly to the LGPS Funds, as currently, it might be thought that Regulation 11(3) need not be amended with the current proposal. However, if the exercise of the power of investment is to be limited by reference, for listed assets at least, to a newly created ACS, any statutory prohibition on holding listed assets through any other means would require an amendment to the Investment Regulations. This would be necessary to pre-empt the separate statutory provision in section 2 of the Localism Act 2011 (the general power of competence) which establishes that local authorities have the power to do anything an individual can do, subject to any contrary statutory provision.

It is also relevant to note that LGPS Funds must exercise their investment powers in a fiduciary way (subject only to the current diversification limits on LGPS Funds in Regulation 14 and Schedule 1). This view was endorsed by the recent Law Commission Report on the duties of Investment Intermediaries. Any new direction as to how LGPS Funds should exercise their fiduciary responsibilities with regard to investments would have to take that factor into account.

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<sup>6</sup> As instructed by the Cabinet Office and DCLG, this report does not cover the potential implications of article 18 of the IORP Directive, which may impact on the ability of DCLG to mandate participation in the ACS.

<sup>7</sup> Now PCR 2015 Regulation 10(1)(e)(i)

The LGPS Investment Regulations are silent on the characterisation of the ACS, for the simple reason that the ACS is a newly created legal vehicle, with Regulations dating from 2013. Apart from a minor change in 2013 (made under SI 2013/410) which updated the LGPS Investment Regulations to increase the limit on investments in partnerships from 15 to 30%, the Regulations have not been amended since 2009 and so this is not surprising.

There are other provisions which relate to diversification by reference to different legal structures in the Regulations. These include certain types of collective investment schemes (unit trusts and OEICs) and insurance policies if managed by the same body in Schedule 1 which apply a maximum limit of 35%. Given this background, it is anomalous that the creation of a major new collective investment scheme vehicle, such as the ACS, currently is not reflected in the Regulations.

On this subject of diversification, attention is drawn to Appendix 6A of the December 2013 Report for DCLG and Cabinet Office (pages 73 to 75). In that earlier analysis, SPB noted that it may be possible for an ACS to be regarded for the purposes of the current LGPS Investment Regulations as falling outside those Regulations entirely.

There is, however, a contrary argument that an ACS might still be subject to the 10% single holding limit which applies under Schedule 1, paragraph 6.

If it were to be decided to create an ACS to hold all listed assets, this question would need to be resolved. However, it may be possible to address the question in a different way if, as seems inevitable for the reasons outlined above, the LGPS investment regulations would need to be revised in order to mandate the use of the ACS in any event.

The 10% single holding limit is defined by reference to certain categories of defined investments, i.e.

- "(a) securities of, or in loans to or deposits with, any one body;
- (b) units or other shares of the investment subject to the trust of any one unit trust scheme; or
- (c) in transactions involving any one piece of land or other property".

There are some exemptions to this restriction which do not apply if the investment is made by an investment manager appointed by the LGPS Fund under Regulation 8 (which would not be the case in the present context as the ACS operator would not itself fulfil that function) or where the relevant single holding is in "units or other shares [sic] of the investments subject to the trusts of a unit trust scheme" which is again not relevant because an ACS is clearly not a unit trust scheme, at least for the purposes of FSMA. Hence, the exemption from the 10% restriction under item 6 above does not seem to be available.

In order therefore for the single holding limit to apply to an ACS, one of the three limbs of the definition must be satisfied. We have already noted that an ACS is not a unit trust scheme, so the second part of the definition does not need further discussion.

Since we have also noted that, for the purposes of this report, the proposed ACS would be used to hold listed assets only, the third limb which relates to real estate may also be ignored. That leaves the third part of the defined term which refers to single holdings by reference to securities, loans and deposits. It is not obvious that an ACS itself, since it is merely a contractual arrangement whose purpose is to hold underlying property in common, issues securities (the legislation refers instead to units); still less could an ACS be said to be a lender or deposit taker.

As a preliminary view, therefore and leaving aside alternative assets such as real estate, we would suggest that the limit on single holdings must apply (if it applies at all) either to the underlying securities or loans (if that term can be construed to include traded debt instruments) which are the property of the ACS as a whole or to a sub-fund which holds such securities or loans.

This interpretation would lead to an anomalous advantage where another form of tax transparent vehicle (the limited partnership) is subject to a separate and clearly identifiable limit (defined by reference to partnership interests generally) of 30% should be noted.

SPB recommends that the legislative ambiguities in this area are such that the Government should clarify, via reform of the LGPS Investment Regulations, what its intentions are if LGPS Funds are to be encouraged to use ACS for pooling of investments.

## 2. Public procurement considerations

Public procurement law will need to be taken into consideration at two levels: first, regarding the relationship between the LGPS Funds and the Operator; and second, regarding the contracts entered into by the Operator with third parties (“onward procurement”). We have considered the former in Section 4.1.3 and the latter in Section 5. We have assumed that for reasons of timing and cost efficiency, the optimum structure will be one where procurement obligations are minimised. That objective may not necessarily be consistent with other policy objectives.

Any agreement between the LGPS Funds and the Operator will be a public services contract for the purposes of the PCR. The LGPS Funds are contracting authorities within the meaning of the PCR and will enter into a contract in writing for consideration under which the Operator will be engaged to provide services. This principle applies regardless of who owns or establishes the Operator. It is also assumed that the value of the contract will exceed the applicable thresholds above which the PCR requirements apply in full.

As described in Section 5, the Operator could be either: (i) a body set up by participating LGPS Funds or (ii) an appointed private body. The nature of the Operator will impact upon the procurement requirements applicable to the contract between the LGPS Funds and the Operator (as well as onward procurement). In broad terms, there is greater scope to avoid the full application of the PCR if the Operator is set up the LGPS Funds rather than appointed by the LGPS Funds.

There is no general exemption to the PCR for contracts entered into between public authorities. It is also not relevant for these purposes whether the Operator seeks to make a profit or merely cover its own costs. However, there are grounds to argue that a contract between the LGPS Funds and an Operator that they set up is not one that has to be competitively procured. There is an exception to the normal application of procurement rules in cases where contracting authorities award contracts to “in-house” providers.<sup>8</sup> The so-called *Teckal* exemption applies where<sup>9</sup>:

- i. a contracting authority exercises a similar level of control over the provider to that which it exercises over its own departments, and
- ii. the provider carries out the *essential* part of its activities with the authority that controls it.

The first limb of the *Teckal* test, which assesses the control of the provider, would be more easily satisfied if the LGPS itself set up the Operator. In the alternative, whereby the Operator was established before being awarded a contract by the LGPS, it is less clear whether this criterion would be satisfied. In principle, for the exemption to apply, the contracting authority itself must exercise control over the service provider.

As regards the second limb of the test, The draft PCR 2015 specify that more than 80% of the activities of the service provider must be carried out in the performance of tasks entrusted to it by the controlling contracting authority to satisfy the second limb of the exemption. We assume that this criterion would be satisfied by the Operator as it will not provide services to third parties. The exemption does not apply if there is private capital participation in the provider. Therefore, the LGPS Funds will *not* be able to rely on the *Teckal* exemption if the Operator is privately appointed and is unlikely to apply if the Operator is established as a public venture. In this regard, the draft PCR 2015 state that there must be “no direct private capital participation in the controlled legal person with the exception of non-controlling and non-blocking forms of private capital participation required by national legislative provisions ... which do not exert a decisive influence on the controlled legal person”.

In addition to the possible exemption under *Teckal*, the contract between the LGPS Funds and the Operator may, however, also be excluded from the PCR by virtue of Regulation 6 (2) (h). This exemption, if applicable, could be used whether the Operator is set up or appointed, or takes the form of a JV. Regulation 6 (2) (h) exempts the award of contracts “*for financial services in connection with the issue, purchase, sale*

<sup>8</sup> The public procurement rules also do not apply where two or more public authorities cooperate amongst themselves to deliver a service, provided that certain detailed conditions are satisfied (in light of Case C-480/06 *Commission v Federal Republic of Germany*). Based on our current understanding and subject to a more detailed review, it does not appear likely that this exemption will apply to the relationship between the LGPS Funds and the Operator.

<sup>9</sup> See Case C-107/98 *Teckal Srl v Comune de Viano and Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia* [1999] ECR I-8121.

*or transfer of securities or other financial instruments in particular transactions by the contracting authorities to raise money or capital.”*

To determine whether the exemption in Regulation 6 (2) (h) will apply to the contract with the Operator requires further analysis of the proposed ACS. However, there are at least *prima facie* arguments that it will, provided in particular that the main object of its contract consists of “financial services” and that these services are “in connection with transactions in “securities”, within the meaning of that Regulation. “Securities” are widely defined in the Regulation and it is reasonable to assume that the majority of the underlying listed assets that will be held in the funds controlled by the Operator would fall within this category. Further assessment would be required to determine whether other assets, in particular unlisted assets, could be classed as securities and whether this may impact upon the application of Regulation 6 (2) (h).

It should also be noted that the wording of the exemption has been altered in the PCR 2015 as follows, in draft Regulation 10(1)(e) : “*financial services in connection with the issue, sale, purchase or transfer of securities or other financial instruments within the meaning of Directive 2004/39/EC of the European Parliament of the Council, central bank services and operations conducted with the European Financial Stability Facility and the European Stability Mechanism*”. This does not alter our analysis.

If Regulation 6 (2) (h) applies to the contract with the Operator, it will not be subject to the full requirements of the PCR irrespective of the nature of its establishment (i.e., whether set up, appointed or a JV). If Regulation 6 (2) (h) does not apply (and, in the case of a set up Operator, the *Teckal* exemption does not apply), the contract with the Operator will require a competitive procurement process through the OJEU.

### **3. Oversight Board: establishment and ownership**

As section 4.2 explains, we have proposed that separate oversight entities are established in order to act as an interface with ACS operators. Certain key questions, therefore, arise in relation to the oversight entities, which are as follows:

1. What legal structure can these body take?
2. Are there any different consequences arising from the choice of a legal structure?
3. Is there any restriction on who may be a shareholder in the oversight entity?
4. Are there any restrictions on the appointment of directors to the oversight entity?
5. Are there any restrictions on the functions that may be delegated to the oversight entity from the LGPS Funds?
6. Can the oversight entity procure the appointment of the ACS operator and any other parties?

#### **1 Legal Structure of the oversight entities**

Given that the oversight entities' operating functions are at this stage not finalised, there is no express restriction on the legal form which an oversight entity could take. However, the central prerequisite that we have set out in this report is that it must provide a means of representation for the participating LGPS Funds in relation to a ACS operator. As such, the legal structure needs to be pre-determined in such a way as to prevent the oversight entity from having an impractical operating structure, but one that is sufficiently robust to answer any criticisms from third parties (bearing in mind that as a public body, whoever owns it, it will be subject to the Freedom of Information Act 2000).

It is important to remember that an oversight entity cannot exercise certain functions itself, since it is neither a "participant" in the ACS (i.e. a unitholder), nor would it be desirable for it to have an executive function within the ACS operator which requires it to be authorised in any way by the FCA. Its functions therefore are circumscribed by having an advisory role on behalf of the participating LGPS Funds and monitoring in respect of the ACS operator.

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Under local government law, the oversight entity could take the structure of a joint committee or a corporate body, which in turn could be a company limited by shares or guarantee or an unlimited company.

## 2 What are the consequences stemming from the choice of legal structure for the oversight entity?

The current statutory position is set out under the LGHA with regard to both committee functions and companies in which local authorities have interests. Part I of the LGHA and specifically section 15 provides that there must be a political balance on committees which are subject to that part of the Act. This provision applies (by virtue of Schedule 1 paragraph 2(1)(e)) to a pensions committee established in accordance with regulations made under Section 7 of the Superannuation Act 1972 which falls within the scope of Section 15 and therefore is bound to have political balance. The position of joint committees is complicated. Paragraph 2(1)(h) to Schedule 1 extends the requirement of political balance to joint committees but only if they do not fall within the preceding sub-paragraphs (ie including sub-paragraph (e)). The Local Authorities (Arrangements for the Discharge of Functions (England) Regulations 2000, Regulation 12(1) confirms that where a joint committee is appointed under section 101(5) of the LGA "the political balance requirements shall not apply". The equivalent Welsh regulations are the Local Authorities (Executive Arrangements) (Discharge of Functions) (Wales) Regulations 2002, Regulation 12(1).

By contrast, Part V of the LGHA, which defines companies which are "controlled" or is subject to the influence of local authorities, are subject to the requirements of Section 70 of the Act. Section 70 merely provides that the Secretary of State may, by order (i.e. secondary legislation) "make provision regulating, forbidding or requiring the taking of certain actions or courses of action" (Section 70(1)). There are some other consequential provisions in Section 70 which relate to accountability for expenditure and financial transactions entered into by companies which are under the control or subject to the influence of local authorities, but these are no more than one would imagine would apply under local authority legislation generally.

Part V of the LGHA is due to be repealed and replaced by Part 12 of the Local Government and Public Involvement In Health Act 2007 ("LGPIHA"). Section 214 contains similar powers to the current Section 70, although the main drafting change is to refer to "entities" as opposed to companies which are controlled etc. by local authorities. The only other difference between the two statutes is that under the LGHA the Secretary of State is empowered to make an order which applies to all local authorities, particular local authorities or particular descriptions of local authority (Section 70(6)), whereas under the LGPIHA, there is a distinction now made between the Secretary of State's powers in respect of English local authorities and Welsh local authorities.

Finally, Section 73 of the LGHA allows for the provisions of Part V to apply to authorities acting jointly and by committees as if the powers were applicable to a single local authority.

Note that the above statutory provisions only apply to local authorities. Some administering authorities (the LPFA, Environment Agency and South Yorkshire Pensions Authority) are not local authorities so other constitutional provisions may apply.

## 3 Is there any restriction on who may be a shareholder in the oversight entity?

There is no restriction on either an LGPS Fund (i.e. its administering authority) becoming a shareholder in a corporate entity, especially in light of the Localism Act 2011 and the general power of competence under Section 2. This is somewhat at odds with the provisions of Section 71(2) of the LGHA, which reserves to the Secretary of State the power to "approve" the subscription for a shareholding in a company or the ability of a local authority to become a member of company limited by guarantee. That section also gives the Secretary of State the power to prevent the power of appointment of directors of companies, the power to nominate any person to become a member of a company and the power to permit any officer of the authority in the course of his employment to become or remain a member or director of the company. It appears, however, that this power, although expressed positively, is actually a power of veto and the only instances where it has been used have been in relation to transport companies.



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Under Section 3(2)(a) of the Public Service Pensions Act 2013 ("PSPA") there is a general power given to the "responsible authority" (i.e. the DCLG in the case of the LGPS) to make such regulations which are "consequential, supplementary, incidental or transitional" in relation to the LGPS as the responsible authority "considers appropriate". Schedule 3 sets out the scope of scheme regulations in respect of "supplementary matters". There is an extensive list of provisions which are now to be found in the Local Government Pension Scheme Regulations 2013 (SI 2013/2356).

**4 Are there any restrictions on the appointment of directors to an oversight entity?**

See above re section 70 of LGHA; in reality there are no relevant legal restrictions from an LGPS Funds perspective.

**5 Are there any restrictions on the functions that may be delegated to an oversight entity from the LGPS funds?**

It is not intended that decisions about asset allocation, which are currently reserved to the LGPS funds under the LGPS Investment Regulations, would be delegated to any other party since it is important that local accountability is preserved. However, the possibility of using the oversight entity to carry out performance measurement and scrutiny of the ACS operator and any parties appointed by the Operator may arguably entail some delegation of a function that is ancillary to the power of investment (see comments in 3 above regarding paragraph 13 of Schedule 1 to PSPA). Notwithstanding this balance, there are no applicable restrictions which would prevent the functions of the LGPS funds from being delegated to the oversight entity. Certain other functions as set out in the Local Authorities (Alternative Arrangements) (England) Regulations 2001 and the equivalent Welsh regulations contain detailed provisions about non-delegable functions, but these are not relevant.

This ties into the use of cost sharing structures which take advantage of the Teckal exemption from procurement legislation set out in Point 2 above, whereby one body discharges the functions of another contracting authority.

**6 Can the oversight entity procure the appointment of the ACS operator?**

On the assumption that the LGPS funds would either own or establish the oversight entity, the oversight entity would likely qualify as a contracting authority for the purposes of the procurement legislation. It could procure on behalf of the participating LGPS funds the appointment of the ACS operator, subject to the normal OJEU procedure. On this subject, please see Point 2 and the analysis of the exemption under regulation 6(2)(h)<sup>10</sup> of the PCR.

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<sup>10</sup> Now PCR2015 Regulation 10(1)(e)(i)



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Department for  
Communities and  
Local Government

# Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies

Consultation response



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# The consultation

1.1 This paper sets out the Government's response to the consultation, *Opportunities for collaboration, cost savings and efficiency*, which ran from 1 May to 11 July 2014. It outlines the main themes raised by respondents under each question and attempts to capture the wide range of views expressed.

1.2 The consultation set out how the Local Government Pension Scheme (the Scheme) could save up to £660 million a year by investing collaboratively and more efficiently. It sought respondents' views on the proposals for reform and how, if adopted, they might be implemented most effectively.

## Background to the consultation

1.3 In 2010, the Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission to review public service pensions and make recommendations on how they might be made more sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers. Lord Hutton's final report was published on 10 March 2011. The report highlighted the collaborative approach being taken by funds within the Local Government Pension Scheme and recommended that the benefits of co-operative working be investigated further.

1.4 Recognising the scope for potential savings to the Scheme, the Department hosted a round-table event with the Local Government Association to consider these issues in May 2013. The objectives for reform identified at the round-table fed into a call for evidence on the future structure of the Scheme that ran from 21 June to 27 September 2013. This asked respondents to consider how the administration, structure and management of the Scheme might be reformed to reduce fund deficits and improve investment returns, as well as cut investment fees and administration costs, strengthen the availability and quality of in-house resource, and improve the flexibility of investments. A copy of the call for evidence and the Government's response is available at <https://www.gov.uk/government/consultations/call-for-evidence-on-the-future-structure-of-the-local-government-pension-scheme>.

1.5 The responses were shared with the shadow Scheme Advisory Board, which provided the Minister for Local Government with an analysis of the responses and a number of recommendations. The shadow Board's findings were also published at <http://www.lgpsboard.org/index.php/structure-reform/board-analysis-menu>.

1.6 The responses to the call for evidence and the recommendations of the shadow Board helped to inform the consultation, *Opportunities for collaboration, cost savings and efficiencies*. In addition, a third piece of analysis was used to shape the proposals, commissioned by the Minister for Local Government and the Minister for the Cabinet Office using the Contestable Policy Fund. Hymans Robertson were chosen to examine three options for reform: creating five to ten merged funds, setting up between five and ten collective investment vehicles (CIVs), or establishing just one collective investment vehicle. This analysis, which identified scope for savings of up to £660 million each year, set out the costs and benefits of each option, the time required to realise any savings, and the practical and legal barriers to implementation. It also included an analysis of Scheme

performance over 10 years based on data provided by 98 local government pension schemes to the WM Company Limited. A copy of the Hymans Robertson report is available at <https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>.

## Summary of proposals

1.7 The consultation, published on 1 May 2014, set out the following package of proposals:

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

1.8 The consultation sought respondents' views on the proposals and how they might be implemented. In particular, interested parties were asked to address the following questions:

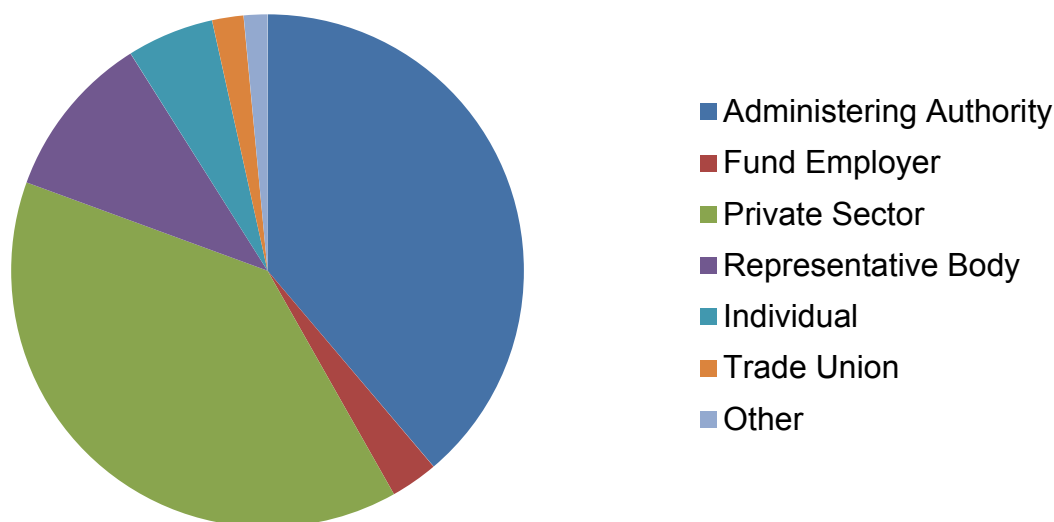
- Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.
- Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?
- Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?
- Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?
- Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

1.9 A summary of the responses received is provided for each question in section four. Several submissions also discussed alternative proposals for reform or ideas for reducing the deficit faced by most administering authorities, since the Scheme as a whole has assets to cover around 79 per cent of its liabilities. An overview of these suggestions is also available in section four.

# Summary of responses received

2.1 201 responses to the consultation were received in total, with both the public and private sector well represented. A full list of respondents has been included in Annex A.

Administering authorities	78	Representative bodies <sup>1</sup>	21
Private sector organisations	78	Individuals	11
Fund employers	6	Trade Unions	4
Other	3		



2.2 The majority of consultation responses agreed that using collective investment vehicles would deliver savings for the Local Government Pension Scheme. Similarly, there was a broad acceptance that there was a role for passive management in a balanced portfolio of investments, although most respondents felt strongly that neither proposal should be made compulsory.

2.3 However, respondents often differed when considering the detail of the proposals. For example, a wide range of views were put forward as to where collective investment vehicles might add most value, or how they should be organised.

2.4 It was commonly argued that further work was required to develop the policy, including setting out what a viable collective investment vehicle structure might look like. In addition, some respondents suggested that alternative governance, investment and administration reforms should be considered, in order to improve fund performance or address deficits. However, no overarching deficit reduction proposals were put forward.

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<sup>1</sup> *Representative bodies* include lobby groups and *Other* includes civil society organisations.

# Government response

3.1 As set out in paragraph 2.1, *Opportunities for collaboration, cost savings and efficiencies* attracted a high level of interest from both the public and private sector, with over 200 responses received. It was clear that a great deal of consideration and effort went into these submissions and we are grateful to the individuals and organisations that provided a response.

3.2 The consultation set out the evidence and rationale for pooling investments through collective investment vehicles and using passive management for listed assets like bonds and equities. It sought to open up for discussion the focus of the reforms and to learn from respondents how the proposals might be best implemented.

3.3 In response to this first issue, the focus of the reforms, respondents were broadly in agreement: Mergers should not be pursued; asset allocation should remain with the administering authorities; and collective investment vehicles, at least in some capacity, offered the opportunity to deliver economies of scale. The Government remains of the view that asset allocation should stay with each of the 90 administering authorities and that savings can be delivered through the use of asset pooling, and in particular collective investment vehicles.

3.4 Respondents offered a wider range of views on the question of implementation. However, two common themes emerged:

- The proposals should not be made compulsory;
- A more detailed proposal is required before any final decisions about implementation can be made.

3.5 The Government recognised that further work was required to develop the policy. Indeed, questions three, four and five of the consultation encouraged respondents to shape the policy and suggest what a detailed package of proposals might look like. Many respondents offered their thoughts in this area, discussing the relative advantages and disadvantages of the different types of collective investment vehicle available, or offering suggestions as to the number of vehicles that might be required and how they should be organised.

3.6 In addition to the responses submitted, the Government commissioned PricewaterhouseCoopers (PwC) to analyse how collective investment vehicles could be best structured in terms of ownership and as legal entities. Their report discussed the different types of collective investment vehicle and concluded that the Authorised Contractual Scheme was likely to be the preferred approach. An Authorised Contractual Scheme is a UK based, tax transparent fund that is regulated by the Financial Conduct Authority and is designed to make it easier for the underlying investors to access the correct rate of tax when buying and selling investments. A copy of PwC's report is available at: <https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>.

3.7 Having considered the evidence and analysis of the consultation responses, the Government decided to pursue a localised approach to reform, inviting authorities to

determine how best to pool their assets and with whom to work. The following announcement was made at the July Budget 2015:

*The Government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The Government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments.*

3.8 Drawing on the consultation responses and discussions with local government and the fund management industry over the summer, the Government has prepared criteria against which the authorities' proposals for pooling will be assessed. Authorities are asked to develop proposals for pooling assets that demonstrate:

- Asset pool(s) that achieve the benefits of scale,
- Strong governance and decision making,
- Reduced costs and excellent value for money, and
- An improved capacity to invest in infrastructure.

3.9 The criteria and supporting guidance have been published and can be found at:

<https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>.

3.10 A consultation has now been launched on draft regulations that would reform the investment regulations and introduce a power of intervention to allow the Secretary of State to intervene in an authority's investment function should it not bring forward ambitious proposals for pooling. The consultation, Revoking and replacing the Management and Investment of Funds Regulations 2009, is open until 19 February 2016 and available at: <https://www.gov.uk/government/consultations/revoking-and-replacing-the-local-government-pension-scheme>.



# The responses in detail

4.1 This section provides a detailed overview of the consultation responses, with quotations used throughout to illustrate the points raised. It captures the views expressed by respondents, and includes notes to supplement the Government's response.

**Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.**

4.2 Over two-thirds of the respondents that expressed a clear view in reply to this question agreed that collective investment vehicles would, at least in some respects, help the administering authorities to achieve economies of scale and deliver savings. Although opinions varied as to where pooled vehicles could add most value, there was a broad consensus that participation should be voluntary, with administering authorities able to invest elsewhere as well.

## **Benefits of collaboration and collective investment vehicles**

4.3 The benefits of collective investment vehicles were widely discussed, with many responses focusing on the opportunity that larger pooled funds presented to reduce asset manager fees. Lower administration, commission and custodian fees were highlighted, as well as a likely fall in transaction costs. It was thought that smaller administering authorities in particular might benefit from access to a wider selection of managers, thereby improving diversification.

The two largest investment management costs for LGPS [the Scheme] are investment manager fees and asset servicing costs. These are both fees typically charged as a basis point fee, with the basis point charge reducing as the size of assets increases. Accordingly, by combining assets together in a CIV, this should result in larger average asset sizes per mandate, and so reduce fees. [1 basis point is equal to 0.01% of assets].

Deloitte

4.4 Some respondents argued that collective investment vehicles could improve governance, as administering authorities would be refocused on setting their investment strategy if they were no longer responsible for manager selection. They were also seen as a means of accessing better advice, as competition amongst suppliers could increase if demand for these skills was concentrated into a few vehicles.

4.5 However, several responses called for alternative means of collaboration to be considered. For example, fee negotiations with asset managers could take place as if the funds had been pooled, but without the formal vehicle structure. Alternatively, greater use of performance related fees could both drive down costs and promote performance; while improving governance arrangements and the skills of pension committees was thought to lead to better manager selection and lower turnover costs.

4.6 A few respondents argued that in-house management should play a stronger role, with existing teams offering shared service arrangements to administering authorities not currently using internal fund management, in order to deliver scale and savings. Joint committees were also suggested, so that better performing administering authorities can support weaker ones.

4.7 Respondents also stressed that existing examples of collaboration, like the National LGPS Procurement Framework, have been shown to save both time and money. Some argued that they might offer the advantages of a pooled fund without the cost of the supporting structure.

Using good quality frameworks saves significant time and money for LGPS [Scheme] Funds, ensures best practice OJEU compliant procurement and provides access to services with proven track record and expertise.

National LGPS Frameworks

4.8 A few submissions highlighted that the existing investment regulations<sup>2</sup> would need to be changed to facilitate substantial investment in collective investment vehicles. They argued that the regulations currently include limits on investment in certain types of investment vehicles which would need to be removed. This follows wider calls for the investment regulations to be reviewed, which have been considered by the Government.

### **Limitations of Collective Investment Vehicles**

4.9 Around 30 respondents queried whether savings would be delivered, especially for larger funds that were thought to already access diverse investments and low fees. Some felt that governance and accountability might be weakened if performance was reported at the group, rather than fund level. The vehicles were also seen as a potential barrier to responding to individual administering authorities' needs; for example if boutique fund managers were excluded or an environmental, social and corporate governance policy was ignored.

Due to focus on fees and capacity CIVs may limit the number of managers funds can choose from. This may exclude some of the boutique managers many of whom have been proven to deliver favourable outperformance net of fees.

Cumbria Pension Fund

### **Making best use of collective investment vehicles**

4.10 Although there was strong support for collective investment vehicles, opinion was divided over where they would add most value. Some respondents felt that pooled funds should only be used for unlisted investments like hedge funds and private equity, while others argued they were most useful for listed assets like bonds and equities. A brief summary of the main arguments from the different view points is provided below.

4.11 Around ten percent of respondents giving a clear response to this question saw no role for collective investment vehicles if passive management of bonds and equities was adopted. Many felt that they were already paying low fees for passive management, by

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<sup>2</sup> The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

using either existing pooled funds or in-house teams. For those using a large, passive pool, creating a new vehicle just for the local government pension scheme was seen as unfavourable, as it could increase transaction costs and would not have a track record of delivery.

For passive investment, the use of a framework agreement that would access the pooled funds of the large passive managers should be considered. An LGPS wide fee arrangement could be negotiated. Such funds have extremely efficient trading operations in place and benefit from strong administration practices, transition management skills and a sound approach to corporate governance.

Tyne and Wear Pension Fund

4.12 In contrast, a few respondents argued that pooled funds would not be suitable for actively managed bonds and equities, as investment managers may restrict access to certain opportunities because they cannot invest a larger volume of assets. Meeting individual administering authorities' needs was also seen as problematic as they may have different investment policies, for example some permit stock lending but not all.

4.13 A further ten percent stressed the benefits of pooled vehicles for illiquid assets like private equity, hedge funds and infrastructure. Some argued that administering authorities newly investing in these asset classes could learn from more experienced ones, as well as reducing costs by sharing expertise and due diligence checks. Smaller administering authorities were also thought to benefit, offering access to these types of investments without needing to use more expensive "fund of funds". Similarly, it was suggested that other administering authorities may be able to more easily to build on existing projects and invest in social infrastructure.

A CIV or any other pooled vehicle for alternative investments could...achieve sufficient scale of pooled assets to establish investments in social infrastructure such as social housing or residential care homes.

Legal and General Investment Management

4.14 However, others felt that a collective investment vehicle for investments like private equity and infrastructure would be less effective, since managers already operating at capacity would have little incentive to reduce fees. Similarly, it was argued that better performing managers may not want to risk having such a concentrated client base and so may choose not to participate in a vehicle just for the Local Government Pension Scheme.

### **Practical constraints**

4.15 Respondents also raised a range of practical issues they wished to see addressed:

- How would the range of skills required for the different types of illiquid assets like infrastructure, private equity and hedge funds be accommodated?
- Would the cost and availability of the resources and skills required to run a vehicle for these illiquid assets be prohibitive? Especially for private equity, where specialist managers with local knowledge and established relationships in several countries may be required?

- Was there not still a case for accessing private equity through a fund of funds, if it provided a better way to diversify investments and manage risk, especially where an existing structure has a track record of strong delivery?

It is important to understand that Fund-of-Funds allow access to specialist investment managers... It could, for example, be argued that an investor like ourselves could build our own private equity portfolio given that we have £100m invested in the asset class. However, it is naïve in the extreme to think that we could build one that is both sufficiently diversified and exposed primarily to “top tier” managers across the World...

Leicestershire Pension Fund

4.16 Several respondents argued that property should not be included in a collective investment vehicle with illiquid assets like infrastructure and hedge funds. The resource required to support investment in property was seen as a significant cost and barrier to its involvement in a new pooled fund. In addition, many highlighted that it would be expensive to move property investments into a different vehicle as stamp duty land tax that would be payable, although respondents differed on the amount it would cost.

However, if ownership of all the £12.1 billion LGPS [Scheme] property assets were transferred to a new vehicle, Stamp Duty Land Tax alone would amount to £486 million.

Association of Real Estate Funds

4.17 A few responses also stressed that the savings identified by Hymans Robertson as resulting from a collective investment vehicle for pooled assets did not include property, which was categorised separately and in some cases held directly. As such, they argued that the savings available from investing in property through a pooled vehicle have yet to be demonstrated.

## Government response

4.18 The Government has reflected on the views received and invited administering authorities to bring forward proposals for pooling their pension scheme assets. In so doing, it will be up to authorities to determine the most suitable mechanism for pooling and the extent to which different investment approaches, such as in-house management, should be used.

4.19 The Government has published a consultation on revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. This proposes to remove the existing limits on investments and instead move towards the prudent person approach to securing a diversified investment strategy that appropriately takes account of risk.

## Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

4.20 There was almost unanimous agreement, amongst those who responded to this question, that asset allocation should remain with the administering authorities. Many felt that this should include implementation style, such as whether to use active or passive management.

### **Asset allocation should remain with the administering authorities**

4.21 Respondents argued that if the liabilities remained with the administering authorities, it was vital that they also kept the means to address them. A locally set investment strategy was seen as essential if an administering authority was to match its investments to its circumstances; including fund maturity, deficit recovery period, cash-flow requirements, the affordability of employer contributions and the desired risk appetite of the administering authority.

4.22 The democratic link to councillors was also emphasised. At present, investment decisions are typically made by councillors through the administering authority's pensions committee. As such, it was argued that those responsible for determining the asset allocation could be held to account directly by council tax payers through local elections.

The decisions on strategic asset allocation are therefore best taken where those liabilities are best understood and where responsibility lies for the future funding which is at individual Pension Fund level.

An Administering Authority

### **Some changes could be made**

4.23 However, some respondents also called for changes to strengthen local decision making, with high turnover of pension committee membership often cited as an issue. A number of suggestions were made, including more peer-benchmarking to consider risk relative to the administering authority's liabilities and investment strategy, publishing evidence of a timely and credible deficit reduction plan, and allowing larger employers such as district councils a clearer say in how the funds and investments are managed.

4.24 The creation of a permanent, professional investment committee was also put forward. Staffed by officials with some councillor representation, it was suggested that this body could be responsible for day to day decisions like manager selection, with the elected pension committee focusing on the long term funding strategy.

### **The existing asset allocation process should be reformed**

4.25 Respondents did not typically call for centralised asset allocation, although some argued that administering authorities should be required to meet a minimum performance or governance standard, with those falling short obliged to delegate asset allocation to a stronger authority. In addition, a few suggested that asset allocation could be collated amongst administering authorities of a similar size or type. They envisaged delegating the detailed asset allocation, but keeping the strategic decisions about fund objectives and high level asset allocation at a local level. However, views differed as to whether this

should be delegated to in-house pension teams who could react quickly to changing market conditions, or centralised through a joint committee to achieve scale and access specialists.

4.26 Merging investment committees or using a Joint Committee structure for a small number of administering authorities was seen as advantageous by some respondents, who felt it would consolidate knowledge and free up staff to monitor fund manager performance. Employers in multiple local government pension schemes were also thought to benefit from this arrangement, as the scale achieved could enable administering authorities to set employer specific investment strategies:

At present, the majority of Administering Authorities run a single investment strategy with all employers having an equal allocation across the chosen asset classes. Increasing the scale through a Joint Committee allows more potential to run multiple investment strategies which could include a standard allocation plus low and high risk options. Individual employers would then have the choice of allocation to best meet their own circumstances and risk appetite. Increasing scale and running with fewer Committees therefore potentially increases local accountability at employer level, as well as allowing a better match of the liabilities at local employer level with the investment strategy of the fund.

Oxfordshire Pension Fund

### **Government response**

4.27 The Government agrees that strategic asset allocation should remain with the local administering authorities. However, as authorities develop proposals for pooling assets, they will wish to revisit and review their decision making processes. For example, while asset allocation should remain a local decision, manager selection should be undertaken at the pool level to maximise savings.

### Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

#### **How many common investment vehicles should be established?**

4.28 Around sixty per cent of respondents expressed a clear view in response to this question, with most suggesting a minimum number of vehicles rather than an exact total. Of those respondents, almost three quarters called for more than two pooled vehicles, with a further fifteen per cent arguing for as much flexibility as possible. A small number of respondents reiterated their view that collective investment vehicles were not needed. They felt that if all of the asset classes required were to be included, it would add complexity and cost to the administration and governance arrangements.

#### A small number are needed

4.29 Around ten per cent of those who responded to this question argued that a small number of vehicles would be most effective, for example between one and three. Having just one vehicle for passive investments was seen as advantageous as it would maximise the opportunities to match buy and sell transactions within the pool, reducing interaction with the market and therefore investment costs. A more diverse range of vehicles was thought to be necessary for illiquid assets like infrastructure and private equity, since different skills and resources would be required for each of these asset classes. This group also warned that replicating the existing range of asset classes and investment styles would lead to a proliferation of ineffective vehicles.

#### Several collective investment vehicles are required

4.30 However, most respondents were in favour of several collective investment vehicles being created. They felt that national vehicles may leave administering authorities insufficiently involved in decision making, or that the governance arrangements would become unwieldy if all 90 authorities were involved. Respondents were also concerned that too few vehicles would increase the funds' exposure to risk. For example, capacity constraints could arise if managers were unable to invest large sums effectively; while other investors may try to exploit the Scheme, aware that any passive investments would need to be rebalanced within known index rules.

However, as noted in the Hymans Robertson report, there are diseconomies of scale above a certain size while a natural ceiling exists for certain asset classes. Capacity concerns may influence the competition in the market if only the largest investment houses can service demand, limiting many of the more niche or boutique managers who arguably over time have outperformed the market and are best placed to add value while also limiting the extent to which downward pressure on fees can be applied.

Wiltshire Pension Fund

4.31 For many, a larger number of vehicles offered better diversification of asset manager and lower risk. A few suggested that between five and eight vehicles would be ideal, with some arguing that competition between vehicles may boost performance.

#### A balanced approach

4.32 Several respondents argued that it was not possible to comment on the number of vehicles required until further work had been done to establish a preferred governance structure and operating model. Others felt that the appropriate number should emerge from the design process, once an optimal size of pooled fund has been determined.

4.33 Balancing the need for strong governance, local accountability and input, along with the desired economies of scale and effective decision making, was also a common theme. Similarly, many thought it essential to balance the savings that could be achieved through scale, with the choice and flexibility required to meet administering authorities' investment needs.

It is widely believed that funds can be too large and subject to capacity constraints, while if not large enough, then potential savings will be significantly reduced. Also, if the mix of asset classes are too diversified, savings could be limited, if not diversified enough, exposure to risk is magnified and may offer limited appeal...Governance arrangements will need to represent the best interest of its members; however if every local authority that manages a pension fund is keen on making representation in the running of the CIV, this would slow down the decision making process and make governance arrangements unwieldy. Therefore a compromise will need to be found.

Milton Keynes Council

### **How should the common investment vehicles be organised?**

4.34 A wide range of ways to organise collective investment vehicles were suggested:

- Creating a vehicle for each **asset class**. This approach was especially popular for illiquid assets like infrastructure, hedge funds and private equity, given the different skills sets, fee structures and access routes involved.
- Using **geographic** groupings or existing networks to facilitate the vehicles, as London Councils are currently doing for the London boroughs.
- Basing vehicles on **risk appetite, investment approach or index**, to help administering authorities deliver their investment strategy, or environmental, social and corporate governance policy. For example, one vehicle might offer the FTSE4Good; a second might be focused on delivering liquid returns; and a third on liability matching.

4.35 Some respondents argued that the number and structure of any vehicles should be decided by the administering authorities, perhaps in response to a clear set of objectives for collaboration set out by Government.

The number and type of collaborative investment vehicles should be limited to provide for the benefits of scale but should be allowed to develop organically and consist of multi asset class structures.

Shadow Scheme Advisory Board



4.36 Finally, several respondents argued that whatever arrangements were put in place, they should offer the flexibility to react to emerging techniques and the changing needs of the authorities. Views were split as to whether this flexibility should extend to competition between vehicles. Some saw this as a means of preventing monopolies, encouraging innovation and driving down costs, while others thought it might lead to short term decision making and unnecessary asset turnover.

### **Which asset classes?**

4.37 Around fifteen per cent of respondents listed the asset classes that they thought should be included. Many set out a wide range, while others called for the current array of Scheme investments to be offered. A few went further, arguing that reducing the choice available could increase risk in the Scheme, as the assets would become more concentrated into certain asset classes or invested with fewer managers.

4.38 A wide range of geographical markets and implementation styles for bonds and equities were requested. For example, the option to manage both actively and passively was often mentioned, with passive management to include approaches such as smart beta, target index approaches and enhanced passive. These tools use index tracking like most passive funds, but allow the investor to set certain parameters under which the fund may deviate from the index like an actively managed investment. A substantial range of bonds and gilts were also referenced, to encompass different redemption periods and varied risk appetites. A few respondents also called for liability matching, although some felt that this, and other means of addressing interest rate and inflation risks, required a tailored approach for each administering authority and so should be organised outside of any collective investment vehicle.

4.39 For investments other than bonds and equities, a similarly broad range was proposed. This included infrastructure, real estate, global and UK property, hedge funds, private equity, private debt, diversified growth funds and absolute returns.

### **Government response**

4.40 The published criteria and guidance for investment reform asks administering authorities to develop proposals for asset pools that meet their needs, including determining how the pools are structured and the asset classes to be offered. However, it is important that authorities develop larger asset pools in order to access the benefits of scale. The criteria therefore set out the Government's expectation that authorities will develop proposals for no more than six pools, each with at least £25 billion of Scheme assets.

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

### What structure should be used?

4.41 Just under forty per cent of respondents gave a clear view about the legal structure they felt should be adopted, for example a unitised vehicle; a limited liability partnership, or an authorised contractual scheme. Many argued that further analysis was required to determine the most appropriate structure, or commented instead on the characteristics they would like to see included. Of those who did indicate a preferred structure, two thirds were in favour of the Authorised Contractual Scheme, with many pointing to London where work is underway to establish this type of vehicle.

#### Authorised Contractual Scheme

4.42 An Authorised Contractual Scheme (ACS) is a tax transparent fund based in the UK. Launched by HM Treasury in 2013, it is regulated by the Financial Conduct Authority and designed to make it easier for the underlying investors to access the correct rate of tax when buying and selling investments both in the UK and overseas. It can take different legal forms, operating as a Limited Partnership or as a Qualified Investor Scheme. The relationship between the investors and scheme operator, as well as the use of sub-funds within the vehicle, depends on the legal structure adopted.

4.43 The Authorised Contractual Scheme was the most frequently discussed structure amongst both public and private sector respondents. The London boroughs have chosen to use this model for their collective investment vehicle and many respondents drew on their analysis, highlighting the following benefits:

- Regulation by the Financial Conduct Authority and by UK law,
- The ring-fencing of assets and liabilities, so that investors cannot be called upon to cross-subsidise each other,
- A tax transparent structure enabling administering authorities to access the right rate of withholding tax,
- New rules on stamp duty land tax which is expected to offer further tax benefits, for example, if a particular structure is adopted, transfers between sub-funds would be exempt from that tax.

4.44 Wider benefits were also cited, including the option to have fund managers accountable to joint committees where several administering authorities could be represented; the opportunity to improve the comparability and transparency of fund data; and the potential to use transparent sub-fund performance data to deliver better returns.

Pooling through an ACS is seen as having particular attractions for pension funds due to its tax treatment, governance structure, and its flexibility when it comes to accessing different asset classes.

Society of London Treasurers

### Other options should be considered

4.45 Although the majority focused on the Authorised Contractual Scheme, a few questioned whether it would be the most practical option. For example, the Authorised Contractual Scheme cannot hold units in Unit Linked Life Trusts, which are often used by the administering authorities to access UK Commercial Property or pooled index funds. Similarly, the vehicle was thought to be potentially tax inefficient for property, as transfers into the vehicle would, at the time of the consultation, be subject to stamp duty land tax. A few respondents suggested that if more than one vehicle were to be established, different structures could be used to reflect the varied needs of the distinct asset classes. For example, a limited partnership or closed ended fund might be appropriate for longer term investments that are hard to convert into cash, like infrastructure. Here the lack of easy subscription or redemption of holdings may be beneficial, but for the same reasons, that structure may not be suitable for more liquid asset classes like equity.

It is, however, important to recognise [that] the current tax legislation result[s] in an ACS structure being potentially attractive for liquid investments such as equity but raises questions around their use for illiquid investments, specifically property if the assets are to be moved in-specie from an existing portfolio into an ACS structure.

Aviva Investors

### Further work is needed to determine the most beneficial structure

4.46 A significant proportion of respondents remained undecided about the optimal vehicle structure or felt unable to comment. Many argued that given the complexity of the question, further work was needed to better understand the options before making a decision. For example, they suggested that even if the Authorised Contractual Scheme was chosen for its tax transparency, a further decision about the legal structure would also be needed – should it be a limited partnership or co-ownership scheme; if the latter, should it take the form of a Qualified Investor Scheme or an Undertaking for Collective Investments in Transferable Securities?

4.47 Instead of proposing a specific vehicle, many respondents from this group set out the characteristics they thought should be present. Typically, they recommended a structure that was cost effective and efficient, transparent and flexible. Direct ownership of assets was also preferred, as was a clear performance management system, so that a manager's contract could be terminated in the event of poor performance.

We recognise that we are not experts in the legal and regulatory structure of CIVs... However we can comment on the characteristics that we would expect to see in such a CIV:

- Appropriately regulated
- Direct Ownership of Assets by investors
- Tax efficiency and transparency
- Segregation of liability at sub-fund level
- Cost efficient
- Flexible (broad range of asset classes and investment strategies)
- Flexible (allow additional asset classes and strategies to be added)

Cheshire Pension Fund

4.48 A small number of responses questioned whether the Government had the legal powers to create collective investment vehicles or require participation in them. Some also suggested that the procurement processes would also need to be carefully thought through depending on the legal ownership and creation of vehicle.

### **What governance arrangements should be established?**

4.49 The role of the administering authority in a collective investment vehicle featured strongly in the consultation responses. Many argued that since the assets were owned by the local administering authorities, it was vital that they retained influence. Respondents were divided as to how this should be achieved, but most suggested some form of councillor involvement.

4.50 A popular proposal was to establish a joint committee of councillors to act as shareholders of the vehicle's operating company, drawing on the approach being taken by the London boroughs where the administering authorities each have an equal shareholding. However, others felt this would be unwieldy, with too many people involved in decision making and governance. They suggested that representative bodies of Chief Finance Officers, or the administering authorities' nominated councillors, select a few councillors to act on all of their behalf.

4.51 Some respondents also argued that Scheme members or independent professional advisors should play a role in the vehicle's governance structure. The model used by the National Employment Savings Trust (NEST) was put forward. It includes an elected body of trustees, a properly qualified executive team, and formal processes for engagement with members and employers. A few respondents also wanted greater delegation to professional managers to enable them to react to opportunities as they arose, for example, by allowing them to decide how an administering authority's investment portfolio is constructed.

Such investment offices should be answerable to a governance board or panel representing the participating funds and their membership. Such boards may benefit from the presence of independent experts or advisers (the equivalent of independent trustees within a corporate trustee context).

Insight Investment

4.52 There was an expectation amongst a few respondents that if collective investment vehicles were established, they would be public sector bodies, with in-house asset management where possible, drawing on skills already present within the Scheme. Some queried whether public sector pay constraints would make it difficult to retain good, skilled staff, while others pointed to the administering authorities that already have in-house investment teams.

4.53 A few respondents also questioned whether the collective investment vehicle should be profit making, with the profit returned to the pension funds. They argued that this would develop a culture of appropriate risk taking which would help the administering authorities to compete in markets against private sector organisations.

Establishing a suitable level of fees is a further governance question. Is the CIV to be profit-making, and if so, should it be owned by the LGPS schemes so that any profit is returned to them? If not profit-making, will it be possible to develop an appropriate internal culture of risk-taking when competing in investment markets against private sector operators?

Linchpin IFM

4.54 Finally, it was important to a few respondents that the structure made it possible for the administering authorities to fulfil their environmental, social and corporate governance commitments and strategies. For example, they argued that asset owners should be able to engage directly with the companies they are invested in and vote independently of fund managers, as set out in the UN Principles of Responsible Investment.

### **Government response**

4.55 The Government has invited authorities to determine their own governance structures and approach to asset pools. In December 2014 PricewaterhouseCoopers were commissioned to analyse the different types of collective investment vehicle and legal structures available. To support authorities in the development of their asset pools, the Government has published this analysis, which is provided for information only. It does not represent the view of Government, and authorities should seek their own professional advice as necessary in the development of their asset pools.

4.56 The Government has included a separate criterion on governance to help authorities develop viable asset pools that streamline decision making while maintaining democratic accountability for the scheme. Authorities will need to design a governance structure that provides them with assurance that their investments are being managed appropriately by the pool and in line with their investment strategy, but also ensures that at the pool level, risk is adequately assessed and managed, a long-term view is taken, and a culture of continuous improvement adopted.

4.57 The Government agrees that authorities should act as responsible, long term investors within a pool and be able to give effect to their environmental, social and corporate governance policies. When developing their proposals for pooling, authorities will therefore need to determine how their individual investment policies will be reflected.

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

4.58 There are two main types of investment approach, which can be used individually or in combination. Passive management typically invests assets to mirror a market in order to deliver a return comparable with the overall performance of the market being tracked. An actively managed fund employs a professional fund manager or investment research team to make discretionary investment decisions on its behalf. By using their expertise, it is hoped that active managers will deliver a level of return in excess of the market's performance, although this comes at a much higher cost than passive management and still has the risk of under performing the index.

4.59 Hymans Robertson considered the performance before fees of equities and bonds in aggregate across the Scheme over the 10 years to March 2013. This new analysis, evaluating the authorities' investments as one Scheme, showed that there was no clear evidence that the Scheme as a whole had outperformed the market in the long term. They concluded that listed assets such as bonds and equities could have been managed passively without affecting the Scheme's overall performance.

4.60 The consultation therefore advocated the use of passive management for bonds and equities, setting out four options for implementation which are discussed below. These ranged from making the proposals compulsory, to asking the administering authorities to consider the benefits of passive management in light of the evidence provided.

4.61 Just over three-quarters of respondents clearly stated a preference for one of the options. Almost all, around 97 per cent, favoured proposal three or four: using a "comply or explain" model or allowing administering authorities to evaluate and act on the evidence presented.

**Option 1: Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.**

4.62 Although no one suggested that passive management should be made compulsory, several respondents recognised that it had a role to play as part of a balanced portfolio. They saw passive management as a means of achieving greater transparency, lower transaction and governance costs, and reduced manager selection risk.

4.63 Some respondents went further, acknowledging that active management does not always achieve outperformance and so calling for a substantially passive approach. It was argued that this would free up resources to focus on governance and ensure that active managers were only used when the administering authority felt strongly that it would see consistent, positive returns.

4.64 However, none of the submissions voiced support for option one and a few asked whether the Government had the legal authority to require administering authorities to

invest in a particular way. Many were concerned that the administering authorities would see lower returns, or called for the risks associated with passive management to be more closely examined. A summary of the issues raised is provided from paragraph 4.76 below.

**Option 2: Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.**

4.65 Many of the respondents saw this as a variant of option one, as the administering authorities would still be required to invest a proportion of their assets in a particular way. As such, they argued that it was not viable for the same reasons that they felt passive management of listed assets should not be made compulsory.

4.66 A few felt that this option offered a balance between local control and the need to ensure a viable Scheme. They suggested that the level of passive management required could be individually negotiated, with better performing administering authorities given more autonomy and a higher percentage applied to those identified as poor performers.

4.67 Option two was also seen by a few respondents as a means to increase the use of passive management to a level that could allow it to be effectively managed through a collective investment vehicle. This would ensure that the scale needed for a pooled fund was achieved, while still allowing for some use of active management of listed assets.

**Option 3: Fund authorities could be required to manage listed assets passively on a “comply or explain” basis.**

4.68 The “comply or explain” approach was most popular with respondents, with around half of those who expressed a clear view preferring this option. It was suggested that a “comply or explain” framework might increase the use of passive management, while also improving the accountability and transparency of fund performance. Some felt that it would allow in-house management to continue, while others thought it could lead to better returns, as it may encourage administering authorities to use active management only where they felt strongly that it would add value.

4.69 However, respondents also argued that greater clarity was needed about how this option would work before reaching a conclusion. In particular, they wanted to ensure that the reporting mechanisms would not be too onerous, to understand what the administering authorities would be expected to “comply” with, and any consequences of non-compliance.

4.70 The 2009 Investment Regulations already require administering authorities to publish a Statement of Investment Principles which sets out the investment strategy adopted by that authority. Some respondents argued that the administering authorities already explain their investment approach through this Statement, while others thought that it could be expanded to meet the requirements of a “comply or explain” system.

4.71 A few responses suggested what the administering authorities might be required to “explain”, such as the rationale for using active management; the reasons for any underperformance; and the governance processes in place, including the arrangements for the effective monitoring of fund managers. In addition, evidence to demonstrate the appropriate use of passive management and smarter benchmarks was also put forward.

4.72 Alternatively, a “perform or explain” framework was also proposed, focused on returns net of fees. Under this approach, administering authorities would be expected to demonstrate that they had considered the balance between the additional value secured and the fees being paid, when making their investments.

**Option 4: Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report.**

4.73 Around a third of those who gave a clear view in response to this question felt that the administering authorities should be able to decide the extent to which they used passive management. They argued that since the administering authorities are best placed to formulate the investment strategy, they should also determine how it is implemented, including when to use active management. Indeed, some thought that this option would allow the administering authorities to ensure that the different reasons for making investments were properly reflected, for example to maximise capital growth, support cash-flow requirements or minimise volatility risk.

...funds increasingly want their managers to achieve a very fund-specific investment profile (return and risk), not just ‘beat the index’. Examples include portfolios with a specific income bias, or risk strategy... or defined (constraints and discretions) set of investment opportunities. There are many examples of perfectly valid implementation styles which are not just about beating the index.

Eric Lambert

4.74 However, some respondents argued that this option would simply maintain the current situation and so not go far enough. They argued that the administering authorities are already expected to consider the advantages of active and passive management when making their investments and the rationale for their approach should be set out in their investment strategy. Despite this, as the evidence in the Hymans Robertson report has shown, the administering authorities have been achieving an aggregate return equivalent to that of passive management, but paying for active. Furthermore, the report indicated that the Scheme as a whole was using less passive management than peer group of large pension funds in the CEM analysis.<sup>3</sup>

**Other options to be considered**

4.75 Finally, a few responses suggested alternative ways to implement the proposals:

- Administering authorities could be required by law to account transparently for all investment fees, including those paid through management contracts, unitised investment vehicles, or to consultants. This could include an explanation of the value added in comparison to that available from the use of in-house management teams.

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<sup>3</sup> Department for Communities and Local Government: Local Government Pension Scheme structure analysis, Hymans Robertson p.14  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/307926/Hymans\\_Robertson\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307926/Hymans_Robertson_report.pdf)



- A cap on active management fees or an overall budget for investment management could be set out, in order to drive down fees and encourage administering authorities only to use active management where they were most confident of securing higher returns.
- The impact of collective investment vehicles on performance could be evaluated before deciding whether to make passive management of listed assets compulsory. It was argued that administering authorities may gain access to better governance and fund managers through the vehicle, helping poorer performing administering authorities to improve so that the Scheme would achieve an aggregate investment return above the passive benchmark. A few responses went further, suggesting that the London collective investment vehicle could be used as a pilot to test the impact of pooling investments on performance.

### **Passive management should not be made compulsory**

4.76 As indicated in paragraph 4.64, while some of the respondents recognised the benefits of passive management, none voiced support for making it compulsory. This section attempts to capture the main reasons put forward for the continued use of some active management, which many felt was important for a balanced investment portfolio.

#### A role for active management

4.77 Respondents from both the public and private sectors sought to demonstrate how the administering authorities had benefited from active management, citing examples of investments that had delivered a return above the benchmark set. Many were concerned that these higher returns, which they felt might outweigh the potential cost savings, would be lost if the administering authorities were required to move to passive management of bonds and equities.

A comparison of lost performance vs. reduced investment fees over this period shows that a total passive approach might reduce this annual cost by £20m over 10 years but this has to be offset against our investment outperformance. Over the last 10 years the Fund has achieved +0.5% returns per annum above the benchmark. Given the average value of the Fund during that period our active approach has added at least £75m to the value of the Fund which more than covers the extra active management costs (£20m) over the same period.

Greater Gwent Pension Fund

4.78 Another popular argument was that the reforms should just apply to the poorer performing administering authorities. Those able to evidence the effective use of active management would not be required to invest passively in bonds and equities. It was suggested that this would bring up the overall performance of the Scheme, without penalising those achieving higher returns. It was less clear how the better performing administering authorities would be identified, although there was a broad consensus that evidence of strong governance and performance to date should be considered.

Of the actively managed equity portfolios, global equity represented by far the greatest proportion of actively managed assets [in London]. Our analysis found that for 2012/13 that in aggregate London Funds would have been £49.4 Million better off had they invested passively – however there were a significant number of funds who were worse off. If only those getting returns lower than the passive benchmark were able to achieve passive returns and those that got superior returns were able to keep those excess returns then London funds would have been £101.3 Million better off.

Society of London Treasurers

4.79 Similarly, some respondents felt that there were some asset classes where active management may add more value, or where passive management might not be suitable. These included less efficient markets such as the emerging markets, more complex asset classes like private equity, and investment strategies that are difficult to replicate using an index, such as a return in excess of a benchmark like LIBOR.<sup>4</sup>

4.80 Most commonly, however, respondents thought that corporate bonds should be managed actively. Some suggested that it was difficult to replicate a corporate bond index passively, so high tracking errors would arise reducing the returns available. Others stressed that because corporate bond indices are based on the value of debt issued, the investors largest holdings would be with the organisations with the most debt. They argued that this increased the chance of a default and investment losses.

4.81 Finally, some suggested the rules of the market and some indices would mean that investment opportunities might missed; for example if the value of the bond was below the threshold for inclusion in most indices. It was also thought that losses would be incurred that could be avoided by active investors:

Standard credit indices have strict rules regarding the credit ratings of the underlying constituent securities to reflect different levels of credit risk. In particular, investment grade indices stipulate that only bonds rated at or above BBB the indices. This means that, should an issuer be downgraded to being rated below investment grade, the bond is forced out of the index at the end of the month of downgrade, forcing index investors to buy distressed prices. Such “fallen angels,” however, often bounce back; losses initially experienced upon, or in the lead up to, a downgrade are partially recouped in the following months. For the passive investor the initial losses are locked in as the bond falls out of the index and subsequent gains are not captured.

Western Asset Management Company Limited

#### Risks and issues of passive management

4.82 Some respondents were concerned that compulsory passive management might increase the administering authorities’ exposure to risk. For example, they argued that passive managers are unable to react to changes in the market, or mitigate risks by selecting investments based on value rather than market position. Others argued that

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<sup>4</sup> LIBOR is the London Interbank Offered Rate. This is the average interest rate estimated by lending banks in London that the average lending bank would be charged if borrowing from other banks.

since passive funds usually follow the relative value of investments in an index, investments can become concentrated or over-exposed to individual companies.

When investors buy the S&P 500 [Standard and Poor's] they are expecting allocation to 500 names. In fact, the top 50 weightings (or 10% of the names) make up almost 50% of the index by market cap – there is more stock specific risk than many might expect.

Unigestion (UK) Limited

4.83 The risk that passive management may lead to lower returns or higher costs than expected was also raised. Most passive funds track the index based on market capital weight, the relative values of the organisations within the index. Some respondents argued that since this market capital weighted approach always follows the movements of the markets, passive funds tend to buy shares when they are getting more expensive and sell them as they are losing value. In addition, it was suggested that active managers might be able to exploit the fact that a higher proportion of the market will be passively invested, since its behaviour will be predictable. As such, active managers may be able to increase their profits at the expense of the Scheme.

#### Environmental, Social and Corporate Governance Policies

4.84 Respondents from the public, private and civil society sectors all highlighted the importance of ensuring that administering authorities could still implement their environmental, social and corporate governance policies. This was thought to be particularly important where an administering authority had signed up to the UN Principles of Responsible Investment. Some responses felt that a passive management approach would prevent the administering authorities from carrying out these policies. For example, an index tracking passive fund could include an organisation that did not meet their environmental standards. Others referenced the Professor Kay Review into the UK Equity Market and Long Term Decision Making,<sup>5</sup> suggesting that the benefits of good stewardship advocated by Professor Kay, such as playing an active role as a shareholder, could be lost if passive management was used.

#### **Government response**

4.85 The Government has considered the responses received and arguments put forward surrounding the use of passive management. Recognising the different needs of each authority, the Government has invited authorities to develop their own proposals to pool their assets. In so doing, authorities will need to address the criterion of reduced costs and excellent value for money. This places the emphasis on authorities to transparently assess their investment costs and fees, and to set out the savings they can deliver over the long term as a result of pooling.

4.86 The Government recognises that both active and passive management have a role to play in the Local Government Pension Scheme. However, authorities should only use active fund management where it can be shown to deliver value for money, and authorities should review how fees and net performance in each listed asset class compare to a

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<sup>5</sup> <https://www.gov.uk/government/consultations/the-kay-review-of-uk-equity-markets-and-long-term-decision-making>

passive index. In addition, authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

## Alternative proposals for reform, and deficit reduction in particular

4.87 The consultation also asked respondents to put forward their proposals for reducing deficits. Some respondents took the opportunity to stress that the deficits had arisen for a number of complex and varied reasons, such as contribution holidays, low gilt yields and increasing longevity. Others offered alternative governance, investment and administration reforms, intended to improve performance or address deficits.

### Improving governance and reporting

4.88 Some respondents felt that improving decision making and governance would lead to higher returns and so help to reduce the deficits. It was argued that decision making would improve with the publication of more data and performance reports, such as:

- Implementing and reporting against the Myners Principles;<sup>6</sup>
- Improving the information provided to beneficiaries, so that they can better understand where the assets are being invested;
- Introducing regulations to require the setting, monitoring and reporting of progress against agreed governance objectives.

4.89 A few submissions also called for greater professionalization of the management of the Scheme, wanting more in-house expertise able to develop and implement investment strategies.

4.90 Alternatively, a small number of respondents advocated an employer focused approach. They proposed establishing administering authorities for larger groups of employers, such as academies or higher education institutes, which may have a common deficit and cash-flow profile. This was thought to offer these employers a greater role in the governance of the Scheme and an investment strategy that better met their circumstances and so was more likely to drive down their proportion of the existing deficit.

### Long term focus

4.91 However, some respondents were concerned that a focus on deficit reduction may lead to a short-term view of performance and lower returns. They argued that administering authorities should adopt a longer-term approach, for example reviewing performance annually rather than quarterly, as recommended by Professor Kay in his Review of UK Equity markets and Long-term Decision-making. It was thought that a longer term approach would lead to high investment returns and therefore reduce the deficit.

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<sup>6</sup> <http://www.thepensionsregulator.gov.uk/docs/igg-myners-principles-update.pdf>

It is still the case that a large majority of funds will hold their asset managers to account for quarterly performance, driving short-term behaviour. Hymans Robertson identify the retention of managers for the long-term, “even through inevitable periods of underperformance”, as a key characteristic of the top ten performing funds they looked at. We believe performance and fees should be structured over time-frames that are measures in multiple years, rather than quarters.

Sarasin & Partners LLP

### **Government response**

4.92 The Government agrees that authorities should take a long-term view of their investments. The consultation on revoking and replacing the existing Investment Regulations 2009 proposes to remove the requirement to review managers’ performance quarterly, encouraging a longer-term view. The criteria for reform also make clear that authorities will wish to consider the findings of the Kay Review when developing their proposals, including what governance procedures and mechanisms would be needed to facilitate long term responsible investing and stewardship through a pool.

# Annex A: List of respondents

330 Consulting Limited  
Adams Street Partners  
AGF International Advisers Co. Ltd  
AllenbridgeEpic Investment Advisers Limited  
AllianceBernstein Limited  
Allianz Global Investors  
Angela Pober  
Aon Hewitt  
AquilaHeywood  
Association of Investment Companies  
Association of Pension Lawyers  
Association of Real Estate Funds  
Association of School and College Leaders  
Aviva Investors  
Avon Pension Fund  
AXA Investment Managers  
Baillie Gifford & Co  
Baring Asset Management  
London Borough of Barking and Dagenham  
Barnett Waddingham LLP  
Barry Town Council  
Bedfordshire Pension Fund  
London Borough of Bexley Pension Fund  
Bfinance UK Limited  
BlackRock  
BNY Mellon  
Brent Pension Fund  
British Private Equity and Venture Capital Association  
British Property Federation and Investment Property Forum  
London Borough of Bromley  
Buckinghamshire County Council Pension Fund  
Cambridgeshire Pension Fund  
London Borough of Camden Pension Fund  
Capital Dynamics  
Capital Group  
Cardiff and Vale of Glamorgan Pension Fund  
Carmarthenshire County Council  
CBRE Capital Advisors Limited  
CBRE Global Investors  
CFA Society of the UK  
Charles Stanley Pan Asset Capital Management Limited  
Cheshire Pension Fund  
Chris Bilsland  
Chartered Institute of Public Finance and Accountancy (CIPFA)  
City and Council of Swansea Pension Fund

City of London Corporation  
Clerus  
Clwyd Pension Fund  
Cornwall Pension Fund  
Councillor John Fuller  
London Borough of Croydon  
Cumbria Pension Fund  
Debra Hopkins  
Deloitte  
Derbyshire County Council Pension Fund  
Devon County Council Pension Fund  
Devon County UNISON  
Dorset County Pension Fund  
Durham County Council Pension Fund  
London Borough of Ealing  
East of England LGA  
East Riding Pension Fund  
East Sussex Pension Fund  
London Borough of Enfield  
Environment Agency  
Eric Lambert  
Essex Pension Fund  
F&C Investment Business Ltd (Private Equity Funds)  
F&C Investment Business Ltd (Sales and Client Relationships)  
Fidelity Worldwide Investment  
First State Investments  
Fred Green  
Generation Investment Management LLP  
Gloucestershire Pension Fund  
GMB  
Greater Gwent Pension Fund  
Greater Manchester Pension Fund  
Gwynedd Pension Fund  
London Borough of Hackney  
Hampshire County Council  
HarbourVest Partners UK Limited  
London Borough of Haringey Pension Fund  
Henderson Global Investors  
Hermes Fund Managers  
Hertfordshire County Council  
London Borough of Hounslow  
Hymans Robertson LLP  
Insight Investment  
Invesco Perpetual  
Investec Asset Management  
Investment Management Association  
Islington Pension Fund  
JLT Employee Benefits  
John Raisin Financial Services Limited




Joint response from civil society organisations  
Jupiter Asset Management Limited  
Kent County Council Pension Fund  
London Borough of Lambeth  
Lancashire County Pension Fund  
Lazard Asset Management - UK  
Legal and General Investment Management  
Leicestershire County Council Pension Fund  
Leslie Robb  
Linchpin IFM, now providing advisory services as City Noble Limited  
Lincolnshire Pension Fund  
Local Government Association  
Lombard Odier Asset Management (Europe) Limited  
London Councils  
London Pension Fund Authority  
Longview Partners  
Loomis Sayles Investments Limited  
M&G Investments  
Majedie Asset Management Ltd  
Manchester City Council  
Mark Solomon  
Markham Rae LLP  
Mercer Limited  
Merseyside Pension Fund  
London Borough of Merton  
MFS International (UK) Limited  
Milton Keynes Council  
MSCI  
National Association of Pension Funds  
National Housing Federation  
National LGPS Frameworks  
Natixis Global Asset Management (UK) Limited  
Neuberger Berman  
London Borough of Newham  
Newton Investment Management Limited  
Nomura Asset Management UK Limited  
Norfolk Pension Fund  
North Yorkshire Pension Fund  
Northamptonshire Pension Fund  
Northern Trust  
Northumberland County Council Pension Fund  
Nottinghamshire Pension Fund  
Osborne Clarke  
Oxfordshire Pension Fund  
Pantheon Ventures (UK) LLP  
Partners Group (UK) Limited  
Peter Moon  
Pictet Asset Management  
PIMCO

PricewaterhouseCoopers LLP  
Principles for Responsible Investment  
Pyrford International Limited  
London Borough of Redbridge  
Rhondda Cynon Taff Pension Fund  
London Borough of Richmond Upon Thames  
Rogge Global Partners  
Royal Borough of Greenwich Pension Fund  
Royal Borough of Kingston Upon Thames Pension Fund  
Royal Borough of Windsor and Maidenhead  
Royal London Asset Management  
Ruffer LLP  
Russell Investments  
Sarasin & Partners LLP  
Schroders  
Shadow Scheme Advisory Board  
Shropshire County Pension Fund  
SKAGEN Funds  
Society of County Treasurers  
Society of London Treasurers  
Society of Pension Consultants  
Society of Welsh Treasurers  
Somerset County Council Pension Fund  
South Yorkshire Pensions Authority  
Squire Patton Boggs (UK) LLP  
Staffordshire Pension Fund  
Stamford Associates Limited  
Standard Life Investments  
State Street Global Services  
Steve Bloundele  
Suffolk Pension Fund  
Surrey Pension Fund  
London Borough of Sutton  
Tameside Council  
Teesside Pension Fund  
Threadneedle Investments  
Torfaen County Borough Council  
London Borough of Tower Hamlets  
Towers Watson  
Tri-Borough pension funds (City of Westminster; London Borough of Hammersmith and Fulham; and the Royal Borough of Kensington and Chelsea)  
Tyne and Wear Pension Fund  
UBS Global Asset Management  
UK Sustainable Investment and Finance Association  
Unigestion (UK) Limited  
UNISON  
Unite  
Universities & Colleges Employers Association (UCEA)  
Vale of Glamorgan Council

London Borough of Waltham Forest  
Wandsworth Council  
Warwickshire Pension Fund  
West Midlands Integrated Passenger Transport Authority  
West Midlands Pension Fund  
West Sussex County Council Pension Fund  
West Yorkshire Pension Fund  
Western Asset Management Company Limited  
Wiltshire Pension Fund  
Worcestershire County Council

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Non-Executive Report of the:  <b>Pensions Committee</b>  9 <sup>th</sup> March 2015	
<b>Report of:</b> Zena Cooke, Corporate Director of Resources	<b>Classification:</b> Unrestricted
<b>Pension Fund Managers Investment Performance Review for Quarter End 31 December 2015</b>	

<b>Originating Officer(s)</b>	Bola Tobun, Investment & Treasury Manager
<b>Wards affected</b>	All wards

## Summary

This report informs Members of the performance of the Fund and its investment managers for the quarter ending 31 December 2015.

For the quarter, the Fund marginally underperformed the benchmark by -0.3%, delivering a positive absolute return of 4.2% against benchmark return of 4.5%.

The Fund is behind its benchmark for the last twelve months to end of December 2015, the Fund returned 2.9%, and it's behind the benchmark by 1.1%.

For longer term performance the Fund outperformed the benchmark by posting three year returns of 8.8% ahead benchmark return of 8.7% and posted five year returns of 6.3% marginally behind benchmark return of 6.5%.

For this quarter end, five out of the eight mandates matched or achieved returns above the benchmark. The Fund performance lagged behind the benchmark over the quarter due to poor returns from GMO, Schroder and Investec.

The Fund is still in line with its long term strategic equity asset allocation and the distribution of the Fund's assets amongst the different asset classes is broadly in line with the strategic benchmark weight.

## Recommendations:

Members are recommended to note the contents of this report.

## **1. REASONS FOR THE DECISIONS**

- 1.1 The report is written to inform committee members of the performance of pension fund managers and the overall performance of the Tower Hamlets Pension Fund.

## **2. ALTERNATIVE OPTIONS**

- 2.1 The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Pension Fund.

## **3. DETAILS OF REPORT**

- 3.1 The Pension Fund Regulations require that the Council establish arrangements for monitoring the investments of the Fund. It considers the activities of the investment managers and ensures that proper advice is obtained on investment issues.
- 3.2 Officers and fund advisers meet regularly with investment managers to discuss their strategy and performance and may recommend that investment managers are invited to explain further to the Pensions Committee.
- 3.3 This report informs Members of the performance of the Fund and its investment managers for the quarter 31 December 2015.

### **3.4 Baillie Gifford & Co**

- 3.4.1 Baillie Gifford manages two distinct mandates; global equity mandate and diversified growth fund mandate. The global equity fund had a value of £118.9m at the start of the mandate in July 2007. The market value of the assets as of 31 December 2015 was £209.2m. The performance target for this mandate is +2% to 3% above the benchmark MSCI AC World Index gross of fees over a rolling 3-5 year periods.
- 3.4.2 The diversified growth fund mandate was opened in February 2011 with contract value of £40m. £6.409m was added to this portfolio during the month of June 2015. The market value of assets as at 31 December 2015 was £56.4m. The performance target for this mandate is to outperform the benchmark (UK base rate) net of fees over rolling 5 years with annual volatility of less than 10%.

### **3.5 GMO**

- 3.5.1 GMO manages a Global Equity Mandate, the initial value of assets taken on at the commencement (29 April 2005) of the contract was £201.8m. On 25 November 2014, £20.8m was redeemed from the portfolio; further £10.674 was redeemed from the portfolio on 29 May 2015 in order to keep the strategic asset allocation weight in line with the investment policy. The portfolio had a market value of £241.4m at 31 December 2015.
- 3.5.2 The performance target is to outperform a balanced global equity benchmark by 1.5% per annum net of fees over a rolling three year period.

### **3.6 Investec Asset Management**

- 3.6.1 Investec manages a Global Bond Mandate which at 31 December 2015 had a market value of £98.4m. The initial value of the assets taken on at the commencement (26 April 2010) of the contract was £97m.
- 3.6.2 The performance target is to outperform the benchmark (3 Month LIBOR) by 2.0% per annum net of fees over a rolling three year period.

### **3.7 Legal & General Investment Management**

- 3.7.1 Legal & General was appointed (2 August 2010) to manage passively UK Equity and UK Index-Linked Mandates, which at 31 December 2015 had a market value of £218.4m. The value of the assets taken on at the commencement of the contract was £204.7m.
- 3.7.2 The performance target is to track the FTSE All Share index for the UK Equity mandate and FTSE A Gov Index-Linked > 5 years benchmark for the UK Index-Linked Mandates.

### **3.8 Ruffer Investment Management**

- 3.8.1 Ruffer manages an Absolute Return Fund; the value of this contract on the 28 February 2011 was £40m. £6.474m was added to this portfolio on 02 June 2015. The value of assets under management as of 31 December 2015 was £54.3m.
- 3.8.2 Their overall objective is firstly to preserve the capital over rolling 12 month periods and secondly to grow portfolio at a higher rate after fees than could reasonably be expected from the alternative of depositing the cash value of the portfolio in a reputable UK bank.

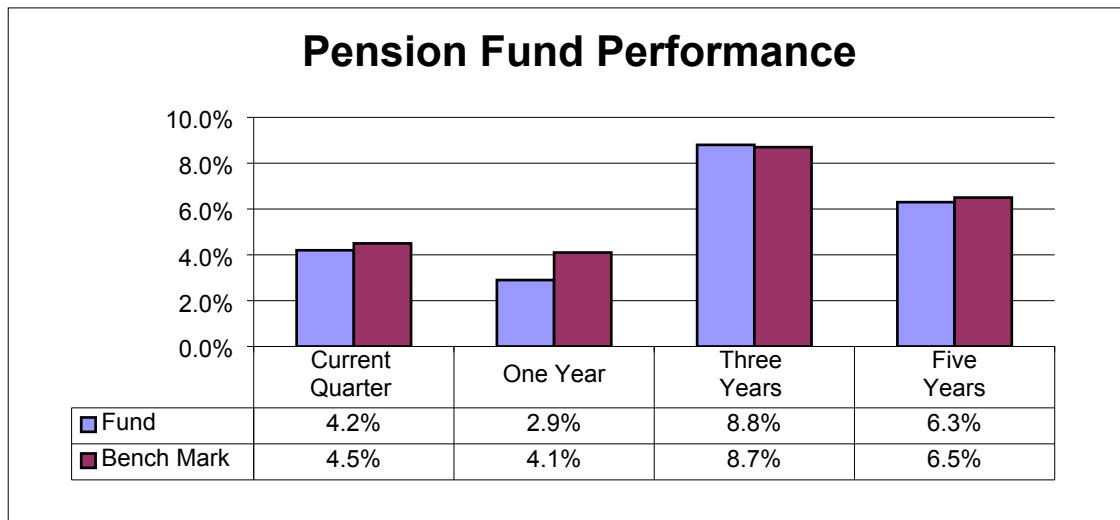
### **3.9 Schroder's Investment Management**

- 3.9.1 Schroder manages a property mandate. The value of this mandate on 20 September 2004 was £90m. The market value of assets at 31 December 2015 was £132.99m.
- 3.9.2 The performance target for this mandate is to outperform the IPD UK Pooled Property Fund Indices All Balanced Funds Median by 0.75% net of fees over a rolling three year period.

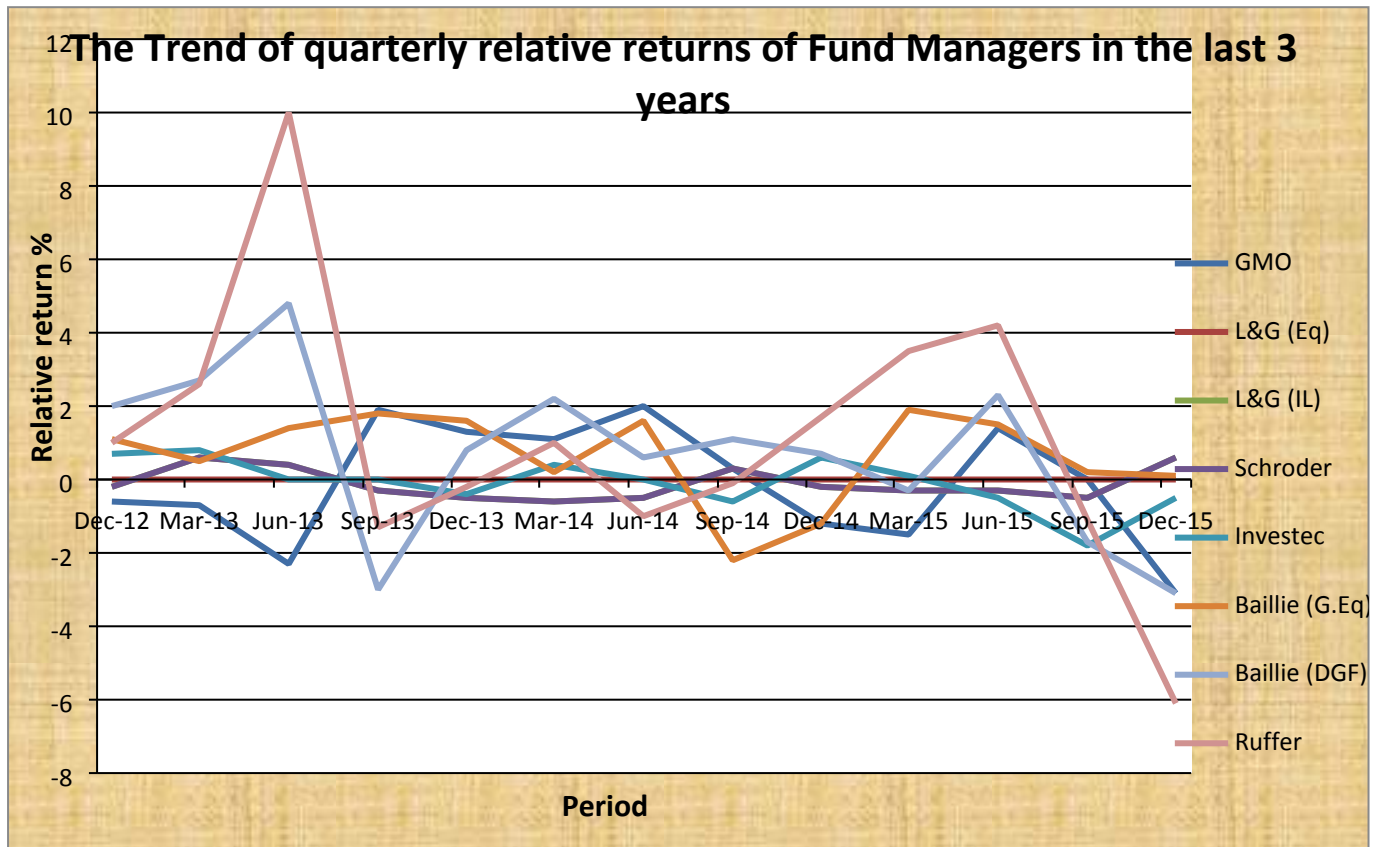
### **3.10. INVESTMENT PERFORMANCE**

- 3.10.1 The Fund's overall value appreciated by £46m from £1,071.6m as of 30 September 2015 to £1,117.6m as of 31 December 2015.
- 3.10.2 The fund underperformed the benchmark slightly this quarter with a return of 4.2% compared to the benchmark return of 4.5%. The twelve month period sees the fund underperforming the benchmark by 1.1%.
- 3.10.3 The performance of the fund over the longer term is as set out in the chart below.

**Table 1 – Pension Fund Performance**



3.10.4 The graph below demonstrates the volatility and cyclical nature of financial markets, but the outcomes are within the range of expectations used by the Fund actuary in assessing the funding position. The Fund can take a long term perspective on investment issues principally because a high proportion of its pension liabilities are up to sixty years in the future.



**3.11 MANAGERS**

3.11.1 The Fund employs six specialist managers with eight mandates. The managers, mandate and funds held under management are set out below:

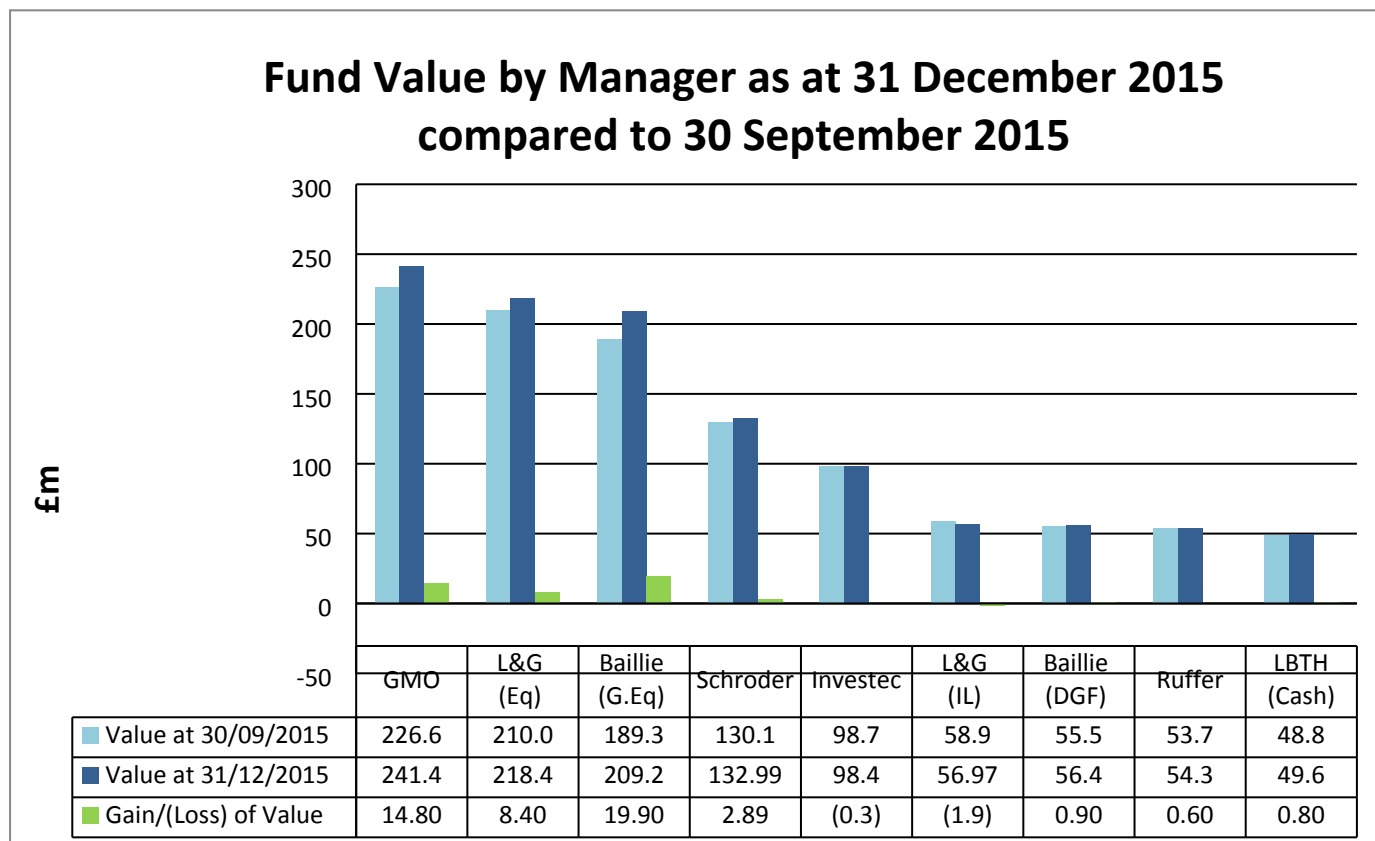


**Table 2: Management Structure**

Manager	Mandate	Value £M	Weight Target of FM AUM %	Actual Weight of FM AUM %	Over/(Under) Weight Target %	Date Appointed
GMO	Global Equity	241.4	23.0%	21.6%	(1.4%)	29 Apr 2005
Baillie Gifford	Global Equity	209.2	18.0%	18.7%	0.7%	5 Jul 2007
L & G UK Equity	UK Equity	218.4	20.0%	19.5%	(0.5%)	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	56.4	5.0%	5.0%	0.0%	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	54.3	5.0%	4.9%	(0.1%)	8 Mar 2011
L & G Index Linked- Gilts	UK Index Linked	57.0	3.0%	5.1%	2.1%	2 Aug 2010
Investec Bonds	Bonds	98.4	14.0%	8.8%	(5.2%)	26 Apr 2010
Schroder	Property	133.0	12.0%	11.9%	(0.1%)	30 Sep 2004
Cash	Internal cash management	49.6	0.0%	4.4%	4.4%	
<b>Total</b>		<b>1,071.6</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.00%</b>	

3.11.2 The Fund was valued at £1,071.6million as at 31 December 2015. This includes cash held and being managed internally (LBTH Treasury Management), this stands at 4.4% of the total assets value.

3.11.3 Market performance for the quarter is illustrated below by depicting the fund value by manager for this reporting quarter compared to the last quarter.



3.11.4 The performance, gross of fees of the individual managers relative to the appropriate benchmarks over the past five years is as set out in table 3.

**Table 3: Manager Investment Performance relative to benchmark**

Manager	Current Quarter	One Year	Three Years	Five Years
GMO Global Equities	-1.60%	-3.60%	-0.80%	-0.80%
Baillie Gifford Global Equities	2.30%	4.10%	3.00%	2.00%
L & G UK Equity	0.00%	0.10%	0.10%	0.10%
Baillie Gifford Diversified Growth	0.60%	-1.90%	0.30%	N/A
Ruffer Total Return Fund	0.50%	-2.70%	2.60%	N/A
L & G Index Linked-Gilts	0.00%	0.00%	0.00%	0.00%
Investec Bonds	-1.00%	-3.90%	-2.10%	-2.40%
Schroder	-0.60%	-0.80%	-0.90%	-0.80%
<b>Total Variance (Relative)</b>	<b>-0.30%</b>	<b>-1.10%</b>	<b>0.10%</b>	<b>-0.20%</b>

**3.12 GMO** - The portfolio performed discouragingly by posting a positive return of 6.4% against a target return of 8.1% over the quarter

3.12.1 The manager stock selection and the Emerging Markets overweight position contributed positively to performance in this reporting quarter. Russia Energy and Brazil Utilities were among the larger Country-sector holdings that detracted from returns along with an underweight in China Information Technology whilst positions in financials in south African and Turkey contributed positively.

3.12.2 Stock selection in Canada was the main contributor to the underperformance in this reporting quarter, driven detrimentally by the weight of Valeant Pharmaceuticals in the portfolio.

3.12.3 The portfolio European value position accounted for approximately 27% of the total portfolio weight during the quarter. The European Value stocks trailed the MSCI ACWI during the quarter. Stock selection was positive in France, Germany and the U.K. Renault contributed significantly positive to the reporting quarter returns.

3.12.4 U.S. high quality accounted for approximately 21% of the portfolio total weight during this quarter. The underweight to the US hurt relative performance and also the high quality stocks underperformed the U.S market during the period although strong stock selection particularly Amazon, Information Technology and Health Care stocks produced strong returns.

**3.13 Baillie Gifford** – the portfolio slightly outperformed the benchmark of +8.5% over the quarter, delivering a return of +10.5% resulting in relative outperformance of 2.4%. The portfolio is relatively concentrated and seeks to generate strong absolute returns over the long-term through the use of an unconstrained bottom-up approach. The portfolio also delivered on this over the longer term, as performance remains ahead of the benchmark over 3 years and 5 years.

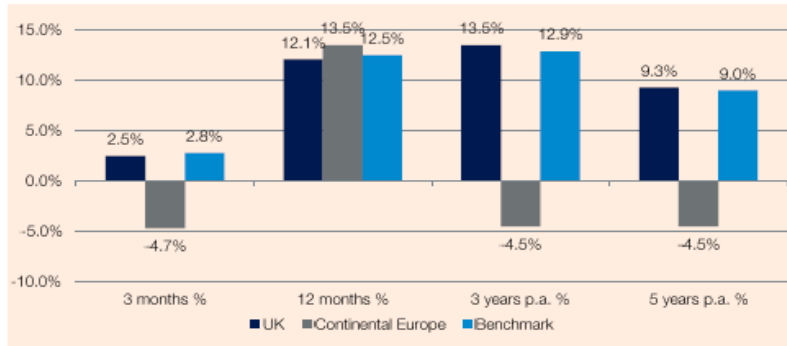
- 3.13.1 The largest major stocks contributors to performance were Amazon, Royal Caribbean Cruises, Ryanair, Alphabet and Naspers. These companies have seen significant price appreciation over the past year.
- 3.13.2 Within all of its portfolios, Baillie Gifford has had a notable overweight to consumer discretionary and technology/internet retailing stocks which have benefitted returns greatly in the past.
- 3.13.3 The portfolio has very limited exposure to traditional petrol or diesel powered cars; Fiat Chrysler and Volvo, the truck manufacturer, are the only two portfolio companies with exposure to these fuel types. Tesla is positioned on the other side of the equation: the move to electric. Tesla's renewable credentials can be challenged simply because the electricity used to re-fuel the car is probably generated from a coal power station. But the Tesla car is one part of the investment story; the Powerwall and Gigafactory are much more interesting when it comes to the transition from petrol to battery powered vehicles and the potential for this company to influence the global renewable energy sector more broadly.
- 3.14 **Legal & General - L & G (UK Equity)** – The portfolio returned +4.0% matching the index return over the quarter.
- 3.14.1 The FTSE 100's heavy weighting in energy and mining companies meant that the overall performance of UK-listed stocks lagged behind that of other major developed markets over the period. This continued a theme that begun in late 2011 as commodity prices peaked, and has been particularly notable during 2015, leading the FTSE 100 to move sideways in the fourth quarter. Meanwhile, domestically focused mid-cap stocks outperformed larger companies, with the environment for the UK consumer remaining relatively robust.
- 3.15 **L & G Index Linked Gilts** – The portfolio returned -3.3% matching the index return over the quarter.
- 3.15.1 Rising expectations of a rate hike by the US Federal Reserve saw major government bond markets lose ground in the fourth quarter of the year. With a strong rebound in investor risk appetite across the globe, investors started to price in the possibility of the first US rate hike since before the global financial crisis occurring in December. In addition, Federal Reserve Chair Janet Yellen sounded a much more hawkish tone in October and November than she had over the summer when concerns over faltering global growth took centre stage.
- 3.15.2 With investors anticipating the rate hike and the Federal Reserve duly raising rates in December, yields in US treasury markets moved higher throughout the quarter, despite the fact that inflationary pressures remained subdued. Although the Bank of England stated that UK interest rates were still likely to remain at historic lows for some time, and the European Central Bank (ECB) extended its asset purchase scheme, yields on UK gilts and German bunds followed treasury market yields higher over the quarter, continuing the overall trend of rising core government bond yields in 2015.

- 3.15.3 European bonds over German bunds (known as 'peripheral spreads') fell markedly over the quarter, towards their lowest levels of 2015. Spain, Portugal and Italy all saw their bond yields fall relative to Germany as investors bet on continued monetary support from the ECB. This continued the theme of falling overall European peripheral spreads since the peak of the European debt crisis in mid-2012.
- 3.15.4 With oil prices, dropping back towards their lows and other commodity prices also falling on balance, inflation-linked government assets underperformed, particularly in December as commodity price falls accelerated.
- 3.15.5 The Fund held all 22 stocks contained within the benchmark index. The Fund and index had a modified duration of 23.6 years at the end of the quarter and the real yield was -0.7% (yield curve basis).
- 3.16 **Investec (Bonds)** – The portfolio delivered a return of -0.40% against a performance comparison index return of 0.6%. It was a difficult quarter for the portfolio after the corporate credit, emerging market debt and currency exposure each detracted from relative returns. More positively, the developed market government bond exposure added to relative returns.
- 3.16.1 Yields on 10-year government bonds rose to 2.27% in the US, 1.96% in the UK and 0.35% in Japan. US Treasury yields ended the quarter higher after the Fed rate hike, while euro-zone bond yields were generally range-bound over the period. Euro-zone bonds initially found support from suppressed inflation expectations, particularly with oil prices falling and the accommodative monetary stance of the European Central Bank (ECB), which was in stark contrast to the Fed. However, the ECB underwhelmed markets with its proposed monetary stimulus at its December meeting, which left investors disappointed and led to euro-zone bonds selling off.
- 3.16.2 Emerging market debt returns were largely governed by a combination of a rebound in October and weakness in November as it became increasingly likely that the Fed would hike rates in December. Credit market moves were largely governed by the fall in oil prices. The US high yield sector, where energy-related names are highly represented, weakened significantly as the asset class as a whole was adversely impacted. European high yield and investment grade markets fared relatively better over the quarter, particularly the latter.
- 3.16.3 **Schroder (Property)** – The portfolio underperformed the benchmark over the quarter by -0.6%, the benchmark posted 2.8% and the portfolio delivered a return of +2.2%. Relative returns are also weaker over the longer term to 31 December 2015, namely twelve months (-0.8%), three years (-0.9%) and five years (-0.8%). This mainly due to the holding in the Continental European Fund 1 (CEF 1) (5% of portfolio).
- 3.16.4 The UK portfolio, which represents the vast majority of portfolio has outperformed the benchmark over three (+0.6%) and five years (+0.3%), although has underperformed over the reporting quarter (-0.3%) and twelve

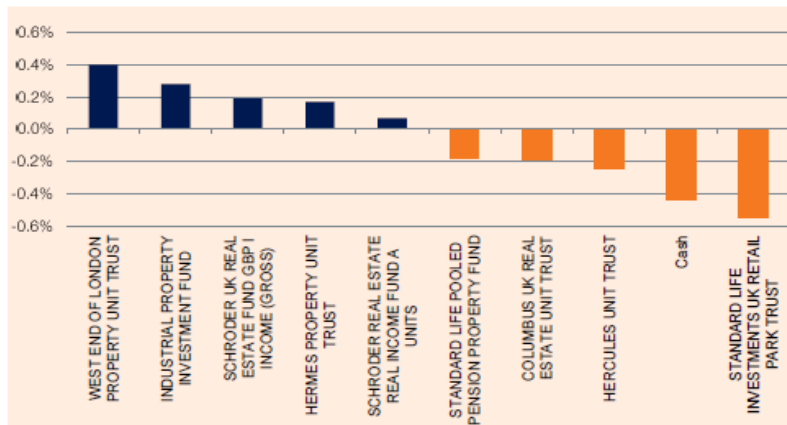
months (-0.4%). Central London offices and the industrial sector have been the strongest performing market segments over the medium term.

3.16.5 Please see below graphs which show the performance in detail.

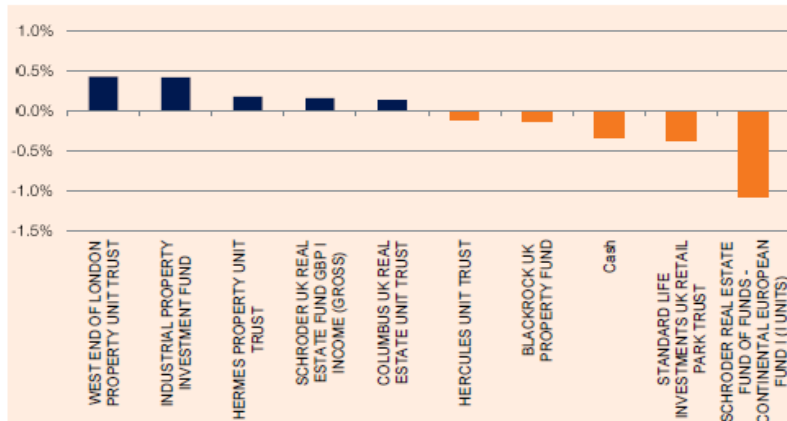
**Total return by region**  
Periods to end 31 Dec 2015



**Total return attribution relative to benchmark top & bottom five contributors**  
12 months to 31 Dec 2015



**Total return attribution relative to benchmark top & bottom five contributors**  
3 years to 31 Dec 2015



3.17 **Baillie Gifford Diversified Growth Fund** generated a return of +1.6% for the quarter outperformed the benchmark of 1.0% by 0.6%.

3.17.1 During the past three months, the largest contributors to performance were absolute return, listed equities and property. Most other asset classes were broadly flat over the quarter, with the exception of a negative contribution from active currency.

- 3.17.2 Over the past 12 months the greatest positive contributors were listed equities, emerging market bonds and absolute return.
- 3.17.3 During the quarter the manager took some opportunities to add to listed equities and high yield credit after market falls. This was somewhat offset by taking profits on investments in US water utilities and German property that had performed very well and where valuations look stretched. The increase in listed equities included an additional allocation to Japan, where the manager feel that further QE, improving corporate governance and increasing equity allocations from domestic pension funds are all positives for the Japanese market.
- 3.17.4 Following the rally in government bonds, the manager sold out of the European Investment Bank holding and the holdings in Australian government bonds. The fund now has a zero weighing in government bonds.
- 3.17.5 The long term performance - The last 12 months to 31 December 2015, the portfolio return was +2.1%, lagging the benchmark return of 4.0% by -1.9% and the last 3 years return was 4.3% above the benchmark return of 4.0%.
- 3.17.6 Please see below charts which illustrate contributions to performance per asset class for the quarter end and 12 months to 31 December 2015.



- 3.18 **Ruffer Total Return Fund (Absolute Return)** – The portfolio returned 1.2% compared to target return of 0.6% over the quarter.
- 3.18.1 **Japan equities** - The confidence with Japanese equities was rewarded as the market rebounded 10% after a torrid third quarter. Japan remains the manager favoured geographic equity exposure, supported by improving corporate profitability and central bank and government stimulus programmes.
- 3.18.2 **Concentrated Stocks** – The portfolio gained from concentrated stock selection within the manager reduced equity allocation. Large holdings for this reporting quarter were Microsoft (+25%) and Boeing (+10%), performed strongly on the back of improved results and forecast upgrades.
- 3.18.3 **Options** – The manager continued to hold option protection given the uncertainties after the sharp summer sell-off, but as equity markets rebounded and volatility subsided, this protection was not required. Hence the allocation to options detracted from returns.
- 3.18.4 **UK index-linked bonds** - Having helped to offset equity losses in the previous quarter, the long-dated bonds gave back most of their gains in a general rise in bond yields as markets prepared for the Fed finally lifting interest rates in December. The long term performance, are ahead of the benchmark. The last 12 months are ahead by 0.2% and the last 3 years by 3.1% above the benchmark returns.

### **3.19 Internal Cash Management**

- 3.19.1 Cash is held by the managers at their discretion in accordance with limits set in their investment guidelines, and internally by LBTH to meet working cash flows requirements, although transfers can be made to Fund managers to top up or rebalance the Fund.
- 3.19.2 The Pension Fund invests in accordance with the Council's Treasury Management strategy agreed by Full Council in February 2015, which is delegated to the Corporate Director of Resources to manage on a day to day basis within set parameters.
- 3.19.3 The cash balance as at 31 December 2015, was £48.8m. This constitutes £15m internal cash flow balance from 2013/14, £25m redeemed from GMO portfolio between November 2014. In addition to current internal cash balance of £8.8m as at 31 December 2015. £45m of this cash is cash awaiting investment into fixed income mandate.
- 3.19.4 Members will continue to be updated quarterly of the Pension Fund in house cash investment strategy. Security of the Fund's cash remains the overriding priority, ahead of yield.

### **3.21 ASSET ALLOCATION**

- 3.21.1 The original allocation of investments between the different asset classes was determined in conjunction with the Council's professional advisors in 2004 and is subject to periodic review by the Investment Panel – the latest review was carried out in January 2014.

Asset allocation is determined by a number of factors including:-

- The risk profile. Generally there is a trade-off between the returns obtainable on investments and the level of risk. Equities have higher potential returns but this is achieved with higher volatility. However, as the Fund remains open to new members and able to tolerate this it can seek long term benefits of the increased returns.
- The age profile of the Fund. The younger the members of the Fund, the longer the period before pensions become payable and investments have to be realised for this purpose. This enables the Fund to invest in more volatile asset classes because it has the capacity to ride out adverse movements in the investment cycle.
- The deficit recovery term. All Council funds are in deficit because of falling investment returns and increasing life expectancy. The actuary determines the period over which the deficit is to be recovered and considers the need to stabilise the employer's contribution rate. The actuary has set a twenty year deficit recovery term for this Council which enables a longer term investment perspective to be taken.

3.21.2 Allocations are therefore considered to be broadly in line with the benchmark. Individual managers have discretion within defined limits to vary the asset distribution. The overweight position in equities has helped the fund's performance in recent months

3.21.3 The benchmark asset distribution and the fund position at 31 December 2015 are as set out below:

**Table 4: Asset Allocation**

<b>Asset Class</b>	<b>Benchmark</b>	<b>Fund Position as at 31 December 2015</b>	<b>Variance as at 31 December 2015</b>
UK Equities	24.0%	22.5%	(1.5)%
Global Equities	37.0%	37.3%	0.3%
<b>Total Equities</b>	<b>61.0%</b>	<b>59.8%</b>	<b>(1.2)%</b>
Property	12.0%	11.9%	0.1%
Bonds	14.0%	8.8%	(5.2)%
UK Index Linked	3.0%	5.1%	2.1%
Alternatives	10.0%	9.9%	(0.1)%
Cash	0.0%	4.4%	4.4%
Currency	0.0%	0.0%	0.0%
<b>Total Equities</b>	<b>100.0%</b>	<b>100.0%</b>	

#### **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

4.1 The comments of the Corporate Director Resources are incorporated in the report



## **5. LEGAL COMMENTS**

- 5.1 Regulation 11(3) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 requires the Council, as an administering authority, to invest fund money that is not needed immediately to make payments from the Pensions Fund. Regulation 11(1) requires the Council to have a policy in relation to its investments. The investment policy should cover the following matters:
- (a) the advisability of investing money in a wide variety of investments; and
  - (b) the suitability of particular investments and types of investments. The Council is also required to have a Statement of Investment Principles in accordance with regulation 12 (1) which cover the following matters:
    - (a) the types of investment to be held;
    - (b) the balance between different types of investments;
    - (c) risk, including the ways in which risks are to be measured and managed;
    - (d) the expected return on investments;
    - (e) the realisation of investments;
    - (f) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments;
    - (g) the exercise of the rights (including voting rights) attaching to investments, if the authority has any such policy; and
    - (h) stock lending.
- 5.2 The Council must take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.
- 5.3 The Council does not have to invest the fund money itself and may appoint one or more investment managers. Where the Council appoints an investment manager, it must keep the manager's performance under review. At least once every three months the Council must review the investments that the manager has made and, periodically, the Council must consider whether or not to retain that manager.
- 5.4 One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate, having regard to these matters, for the Committee to receive information about asset allocation and the performance of appointed investment managers. The Committee's consideration of the information in the report contributes towards the achievement of the Council's statutory duties.
- 5.5 When reviewing the Pension Fund Investment Performance, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty). The Committee may take the view that good, sound investment of the Pension Fund monies will support compliance with the Council's statutory duties in respect of proper management of the Pension Fund.

## **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.
- 6.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

## **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 This report helps in addressing value for money through benchmarking the Council's performance against the WM Local Authority Universe of Funds.

## **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 Any form of investment inevitably involves a degree of risk.
- 9.2 To minimise risk the Investment Panel attempts to achieve a diversification portfolio. Diversification relates to asset classes and management styles.

## **10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 10.1 There are no crime and disorder reduction implications arising from this report.
- 

### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

- [None]

#### **Appendices**

- Appendix 1 - WM Quarterly Performance Review

#### **Local Government Act, 1972 Section 100D (As amended)**

#### **List of "Background Papers" used in the preparation of this report**

Investment Managers Quarterly reports (Investec, GMO, Schroder, Baillie Gifford, LGIM and Ruffer) and WM Quarterly Performance Review. (To be email if required)

#### **Officer contact details for documents:**

- Bola Tobun Investment & Treasury Manager x4733

**WM PERFORMANCE SERVICES**

A State Street Business

**Quarterly  
Performance  
Service**

**LONDON BOROUGH OF TOWER  
HAMLETS - TOTAL COMBINED  
QUARTERLY PERFORMANCE REVIEW**

PERIODS TO END DECEMBER 2015

Produced 01 February 2016

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This page details the performance of the major markets.

	UK Equities	N. America	Europe ex UK	Japan	Pacific	Other Intl.	UK Bonds	O/S Bonds	UK IL	Cash/ Alts	Property
<b>Latest Quarter</b>											
Return %	4.0	9.0	6.1	12.5	8.9	8.6	-1.2	1.8	-2.9	0.1	3.1
<b>Last 12 Months</b>											
Return %	1.0	5.3	5.3	17.6	-4.4	4.8	0.6	3.2	-1.0	0.3	13.8
<b>Last Three Years</b>											
Return % pa	7.3	17.4	9.7	14.7	1.0	13.0	3.2	0.9	5.8	0.4	14.6
<b>Last Five Years</b>											
Return % pa	6.0	12.6	5.8	6.3	1.1	8.7	5.5	1.3	7.4	0.4	10.7
Index Used	FT All Share	FTSE WORLD N	FTSE WORLD E	FT Japan	FT Pac x Jap	FT Wld x UK	UK Gilts AS	JPM Glb x UK	I/L Gilts AS	7 Day LIBID	IPD Monthly

## Fund Structure and Benchmarks

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

### Structure

The Fund is managed on a specialist basis with GMO and Baillie Gifford managing the Global Equities on an active basis. UK equities and UK Index-Linked are passively managed by L&G. Investec manage an absolute return pooled bond fund and Schroders are the property manager. During February 2011, Baillie Gifford and Ruffer were appointed to manage Diversified Growth Funds. From 1/4/14 all manager returns are net of management fees.

### Benchmark

The Fund's performance is analysed relative to customised benchmarks, the weighting and relevant indices are shown below.

On a quarterly basis the Fund will be measured against its Customised Benchmark. On an annual basis there is secondary analysis undertaken relative to the WM Local Authority Universe.

The fund structure and benchmarks are noted below.

	L&G	GMO	Baillie Gifford	Benchmark Indices
Global Equities		100	100.0	MSCI AC World GDR
UK Equities	100.0			FTSE All Share
% Allocation	20.0	23.0	18.0	

	L&G	Investec	Schroders	Baillie Gifford	Ruffer	Total Combined	Benchmark Indices
Global Equities						41.0	MSCI AC World GDR
UK Equities						20.0	FTSE All Share
Pooled Bonds		100.0				14.0	LIBOR 3 Month 2%
UK Index Linked	100.0					3.0	FTSE A Gov Index-Linked > 5 yrs
Property			100.0			12.00	HSBC/IPD Pooled All Balanced Funds Average
Diversified Growth				100.0	100.0	10.0	50% Base Rate 3.5%/ 50% 3 Month LIBOR +2%
% Allocation	3.0	14.0	12.0	5.0	5.0	100.0	

### Targets

GMO: +1.5% p.a. net of fees over a rolling 3 year period.

Baillie Gifford Global Equity: + 2 - 3 % p.a. gross of fees over a rolling 3 year period.

Schroders: +0.75% p.a. net of fees over a rolling 3 year period.

Baillie Gifford Diversified Growth: 3.5% p.a. above the UK Base Rate (after fees).

Investec: 3 Month LIBOR +2% p.a.

Ruffer: Overall objective is firstly to preserve the capital over rolling twelve month periods, and secondly to grow the Portfolio at a higher rate (after fees) than could reasonably be expected from the alternative of depositing the cash value of the Portfolio in a reputable UK bank.

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## Performance Summary

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

### Category - TOTAL ASSETS

This page summarises the overall value and performance of the Fund.

### Fund Value

Values (GBP)'000	Mandate	Value at 30/09/2015	Transactions	Capital Gain / loss	Income	Value at 31/12/2015	% Fund
GMO	Eq Gbl	226,630	1,812	12,984	1,497	241,426	22
L & G	Eq UK	210,051	0	8,379	-26	218,430	20
BAILLIE GIFF	Eq Gbl	189,281	115	19,776	115	209,172	19
SCHRODERS	Prop UK	130,112	879	1,998	879	132,989	12
INVESTEC	Bd Gbl	98,686	0	-317	-65	98,369	9
L & G	Bd UK I/L	58,915	0	-1,945	-6	56,970	5
BAILLIE GIFF	Structured	55,479	21	875	21	56,375	5
RUFFER	Absolute	53,658	0	636	0	54,294	5
INT MGD	Cash	48,823	807	0	97	49,630	4
<b>Total Fund</b>		<b>1,071,636</b>	<b>3,635</b>	<b>42,386</b>	<b>2,512</b>	<b>1,117,657</b>	<b>100</b>

The table shows the value of each Portfolio at the start and end of the period.

The change in value over the period is a combination of the net money flows into or out of each Portfolio and any gain or loss on the capital value of the investments.

# Performance Summary

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

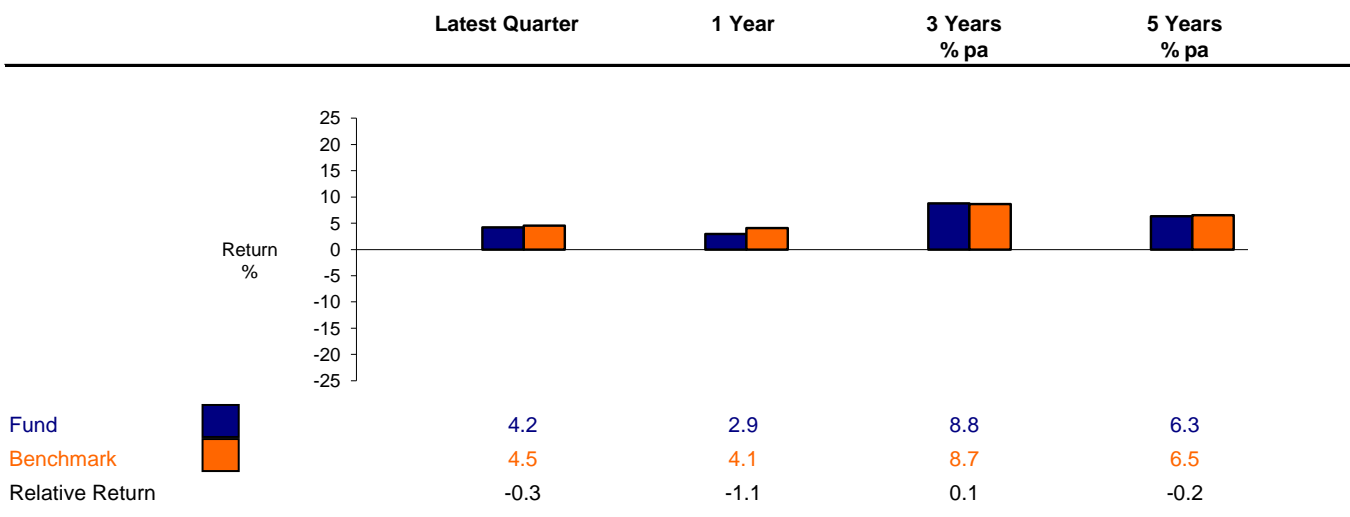
Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

Category - TOTAL ASSETS

This page summarises the overall value and performance of the Fund.

## Fund Returns



The graphs show the performance of the Fund and Benchmark over the latest period and longer term.

The relative return is the degree by which the Fund has out or underperformed the Benchmark over these periods

# = Data not available for the full period



# Detailed Analysis of the Latest Quarter Performance

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

Category - TOTAL ASSETS

This page analyses in detail the Fund performance over the latest period.

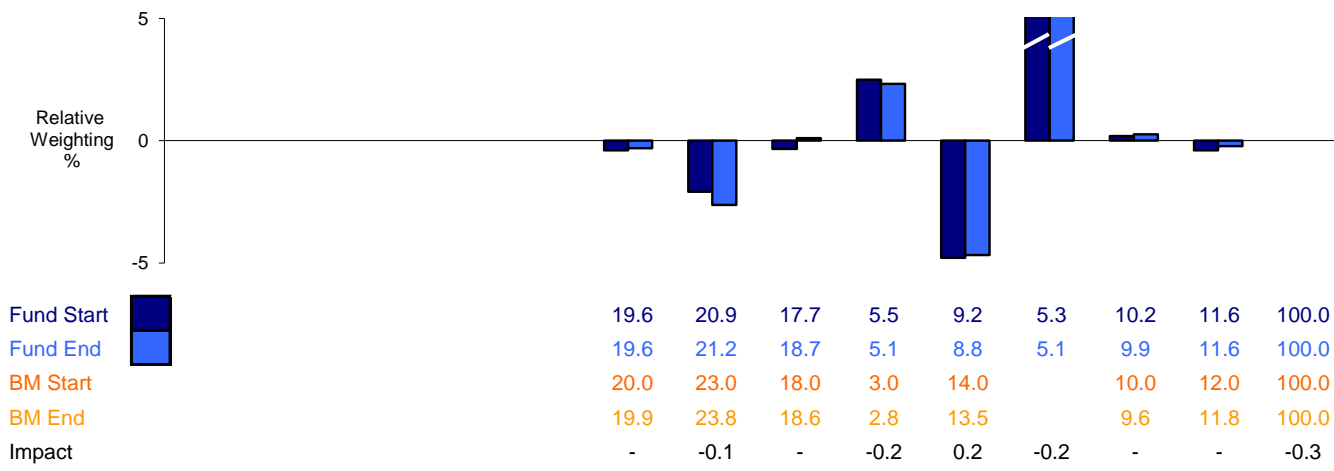
## Summary

Fund Return	4.2
Benchmark Return	4.5
Relative Performance	-0.3
<b>attributable to:</b>	
Asset Allocation	-0.3
Stock Selection	-

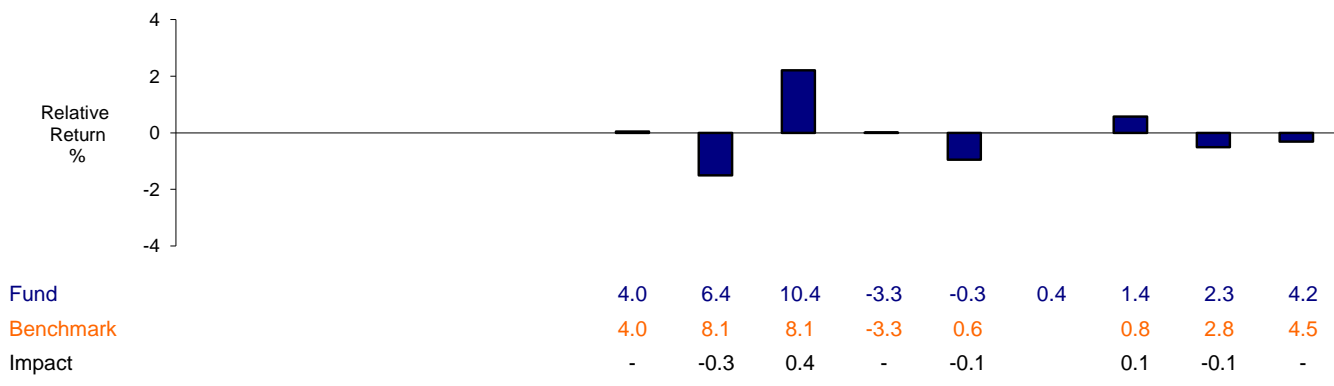
The relative performance can be attributed to the effects of stock selection and asset allocation as detailed below:

	UK Equities	O/S Equities	Global Eq	UK IL	Pooled Bonds	Cash	Alternatives	Property	Total Fund
--	-------------	--------------	-----------	-------	--------------	------	--------------	----------	------------

## Asset Allocation



## Stock Selection



An asset allocation decision will have a positive impact if a Fund is invested more heavily than its Benchmark in an area that has performed well.

Conversely, a positive benefit would be derived from having a relatively low exposure to an area that has performed poorly.

Stock selection will have a positive impact if the Fund has outperformed the Benchmark in a particular area.

The impact of both asset allocation and stock selection is weighted by the level of investment in the area.

# not invested in this area for the entire period

- indicates a value less than 0.05 and greater than -0.05

# Long Term Performance Analysis

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

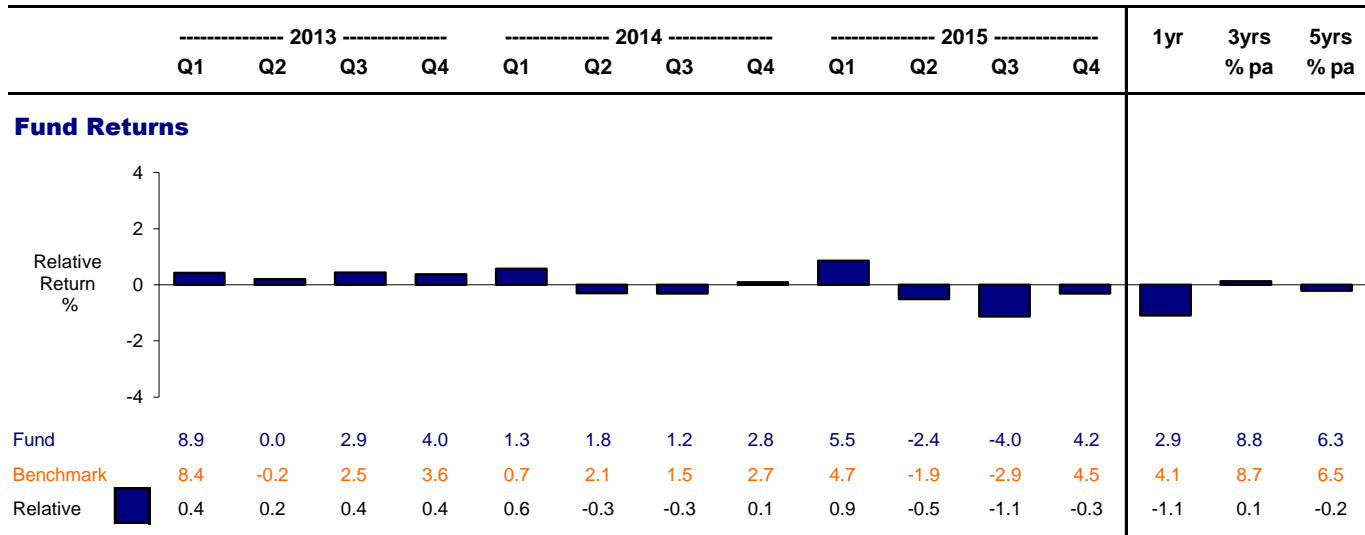
Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

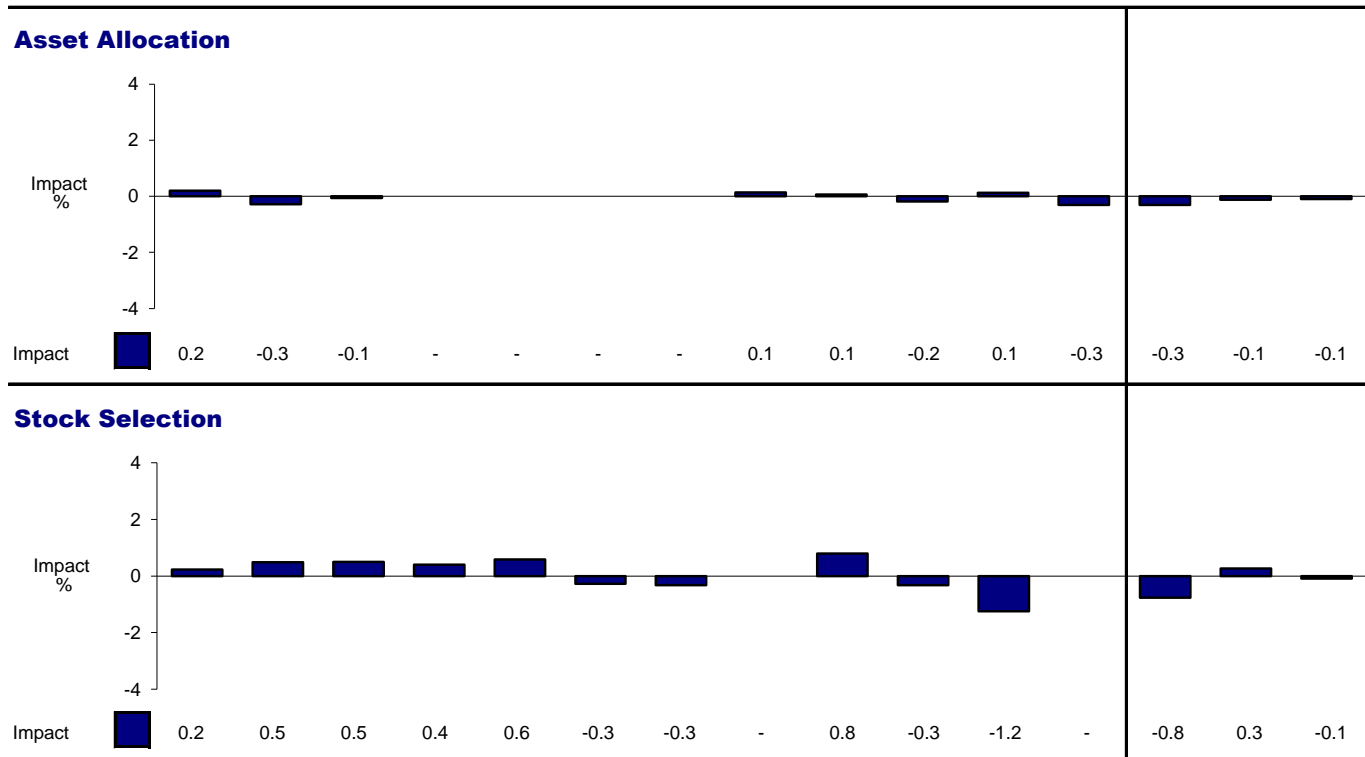
Pound Sterling

Category - TOTAL ASSETS

This page looks in more detail at the long term performance, plotting it relative to the Benchmark.



The relative performance can be attributed to the effects of asset allocation and stock selection as detailed below:



An asset allocation decision will be positive if a Fund is invested more heavily than its Benchmark in an area that has performed well.

Conversely a positive benefit would be derived from investing less heavily in an area that has performed poorly.

Stock selection will be positive if the Fund has outperformed the Benchmark in a particular area.

The impact of both asset allocation and stock selection is weighted by the level of investment in the area.

# not invested in this area for the entire period

- indicates a value less than 0.05 and greater than -0.05

# Long Term Asset Allocation

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

This page looks in more detail at asset allocation decisions, plotting the Fund's exposure at the end of each period relative to the Benchmark and detailing the impact on the total fund performance.

	2013				2014				2015				1yr	3yrs	5yrs
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		% pa	% pa
<b>U.K. EQUITIES</b>															
Relative Weight %															
Fund	22.9	22.8	23.4	23.9	23.0	23.1	22.6	20.0	19.8	20.0	19.6	19.6			
Benchmark	22.5	22.5	22.5	22.5	22.5	22.5	22.5	22.5	20.0	20.0	20.0	20.0			
Impact	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>OVERSEAS EQUITIES</b>															
Relative Weight %															
Fund	22.1	22.4	22.7	22.8	23.1	23.4	23.0	23.0	23.7	22.0	20.9	21.2			
Benchmark	22.5	22.5	22.5	22.5	22.5	22.5	22.5	22.5	23.0	23.0	23.0	23.0			
Impact	-0.1	-	-	-	-	-	-	0.1	-	-	0.1	-0.1	-	-	-
<b>GLOBAL POOLED INC UK</b>															
Relative Weight %															
Fund	17.5	17.8	17.8	18.0	18.0	17.7	17.8	18.4	19.1	18.0	17.7	18.7			
Benchmark	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	18.0	18.0	18.0	18.0			
Impact	-	-	-	-	-	-	-	-0.1	-	-	-	-	-	-	-
<b>TOTAL BONDS PLUS INDEX-LINKED</b>															
Relative Weight %															
Fund	16.0	15.6	15.1	14.5	14.4	14.2	14.4	14.5	13.9	14.0	14.7	13.9			
Benchmark	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0			
Impact	0.2	-0.2	-	-	0.1	-	0.1	0.2	0.2	-0.2	-0.1	-	-0.1	0.1	0.1
<b>U.K. INDEX - LINKED</b>															
Relative Weight %															
Fund	5.5	5.1	5.0	4.8	4.8	4.8	5.0	5.3	5.2	5.2	5.5	5.1			
Benchmark	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0			
Impact	-	-0.2	-	-0.1	-	-	0.1	0.1	-	-	0.1	-0.2	-0.1	-0.1	-
<b>POOLED BONDS</b>															
Relative Weight %															
Fund	10.4	10.4	10.1	9.8	9.6	9.4	9.4	9.2	8.7	8.8	9.2	8.8			
Benchmark	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0			
Impact	0.2	-	0.1	0.1	-	0.1	-	0.1	0.2	-0.1	-0.2	0.2	-	0.2	0.1

For each area of investment the initial weighting for the Fund and the Benchmark is shown and the difference plotted.

The impact will be positive when the Fund is overweight in an area that has outperformed or vice versa.

- indicates a value less than 0.05 and greater than -0.05

# Long Term Asset Allocation

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

This page looks in more detail at asset allocation decisions, plotting the Fund's exposure at the end of each period relative to the Benchmark and detailing the impact on the total fund performance.

	2013				2014				2015				1yr	3yrs	5yrs
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% pa	% pa	% pa
<b>CASH/ALTERNATIVES</b>															
Relative Weight %															
Fund	11.5	11.3	10.7	10.7	11.2	11.0	11.6	13.4	13.0	15.1	15.5	15.0			
Benchmark	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0			
Impact	-0.1	-	-	-	-	-	-	-	-0.1	0.1	0.2	-0.2	-	-0.1	-0.1
<b>TOTAL CASH</b>															
Relative Weight %															
Fund	1.6	1.6	1.3	1.5	2.2	2.0	2.5	4.4	4.1	4.9	5.3	5.1			
Benchmark															
Impact	-0.1	-	-0.1	-	-	-0.1	-	-0.1	-0.2	0.1	0.2	-0.2	-0.1	-0.1	-0.1
<b>ALTERNATIVES</b>															
Relative Weight %															
Fund	9.9	9.7	9.5	9.2	9.0	9.0	9.1	9.0	8.9	10.2	10.2	9.9			
Benchmark	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0			
Impact	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>CURRENCY INSTRUMENTS</b>															
Relative Weight %															
Fund	0.1	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0	0.0						
Benchmark															
Impact	0.1	-	-	-0.1	-	-	-	-0.1	-				-	-	-
<b>TOTAL PROPERTY</b>															
Relative Weight %															
Fund	9.9	10.1	10.2	10.2	10.2	10.6	10.6	10.7	10.5	10.9	11.6	11.6			
Benchmark	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0			
Impact	0.1	-	-	-	-	-	-	-	-	-0.1	-0.1	-	-0.1	-0.1	-0.1

For each area of investment the initial weighting for the Fund and the Benchmark is shown and the difference plotted.

The impact will be positive when the Fund is overweight in an area that has outperformed or vice versa.

- indicates a value less than 0.05 and greater than -0.05

# Long Term Stock Selection

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

This page looks in more detail at the impact of stock selection, plotting the return in each area relative to the Benchmark and detailing the impact on the total fund performance.

	2013				2014				2015				1yr	3yrs % pa	5yrs % pa
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<b>U.K. EQUITIES</b>															
Relative Return %															
Fund	10.3	-1.5	5.8	5.7	-0.4	2.7	-1.2	0.4	4.7	-1.5	-5.7	4.0	1.1	7.6	6.3
Benchmark	10.3	-1.7	5.6	5.5	-0.6	2.2	-1.0	0.6	4.7	-1.6	-5.7	4.0	1.0	7.3	6.0
Impact	-	-	-	0.1	0.1	0.1	-	-	-	-	-	-	-	0.1	0.1
<b>OVERSEAS EQUITIES</b>															
Relative Return %															
Fund	11.4	2.8	4.1	5.6	2.4	2.1	0.9	1.7	9.1	-5.2	-9.4	6.4	-0.3	10.4	6.1
Benchmark	14.6	0.5	2.5	4.2	0.5	2.1	1.8	3.8	7.6	-5.1	-5.9	8.1	3.8	11.4	7.3
Impact	-0.6	0.5	0.4	0.3	0.4	-	-0.2	-0.5	0.3	-	-0.8	-0.3	-0.8	-0.2	-0.2
<b>GLOBAL POOLED INC UK</b>															
Relative Return %															
Fund	15.8	1.7	2.8	5.1	2.0	0.3	1.9	6.4	9.1	-4.9	-5.8	10.4	7.9	15.0	10.0
Benchmark	14.1	-0.1	1.2	5.0	0.5	2.6	3.2	4.5	7.6	-5.1	-5.9	8.1	3.8	11.8	7.9
Impact	0.2	0.3	0.3	-	0.3	-0.4	-0.2	0.3	0.3	-	-	0.4	0.7	0.5	0.3
<b>TOTAL BONDS PLUS INDEX-LINKED</b>															
Relative Return %															
Fund	3.1	-2.5	-0.0	0.0	1.3	0.4	2.8	3.8	1.3	-1.9	1.0	-1.4	-1.2	2.5	2.8
Benchmark	2.1	-0.8	0.6	0.3	1.1	0.7	1.6	2.2	1.1	-0.1	0.9	-0.1	1.9	3.3	3.7
Impact	-	-	-0.1	-	-	-0.1	0.1	-	-	-0.2	-	-0.1	-0.3	-0.2	-0.3
<b>U.K. INDEX - LINKED</b>															
Relative Return %															
Fund	9.0	-7.3	0.6	-0.9	3.6	1.1	5.9	9.4	3.3	-3.3	2.3	-3.3	-1.2	6.5	8.4
Benchmark	9.0	-7.3	0.5	-0.9	3.6	1.1	5.9	9.4	3.3	-3.3	2.3	-3.3	-1.2	6.4	8.4
Impact	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>POOLED BONDS</b>															
Relative Return %															
Fund	0.2	0.1	-0.3	0.5	0.1	0.0	1.2	0.8	0.1	-1.1	0.2	-0.3	-1.1	0.5	0.3
Benchmark	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	2.6	2.5	2.7
Impact	-	-0.1	-0.1	-	-	-0.1	0.1	-	-	-0.2	-	-0.1	-0.3	-0.2	-0.3

For each area of investment the return for the Fund and the Benchmark is shown and the relative return plotted.

The impact of stock selection is the relative return weighted by the level of investment in the area.

# not invested in this area for the entire period

- indicates a value less than 0.05 and greater than -0.05

# Long Term Stock Selection

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

This page looks in more detail at the impact of stock selection, plotting the return in each area relative to the Benchmark and detailing the impact on the total fund performance.

	2013				2014				2015				1yr	3yrs	5yrs
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% pa	% pa	% pa
<b>CASH/ALTERNATIVES</b>															
Relative Return %															
Fund	6.6	-1.8	0.2	1.5	-0.1	1.1	1.8	2.0	2.9	-0.4	-2.3	1.1	1.2	4.1	3.6
Benchmark	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	3.3	3.3	3.2
Impact	0.6	-0.3	-	0.1	-0.1	0.1	0.1	0.1	0.3	-0.1	-0.5	0.1	-0.3	0.1	0.1
<b>TOTAL CASH</b>															
Relative Return %															
Fund	1.5	0.2	-1.0	-0.2	-0.2	-0.2	0.8	0.9	0.6	0.0	0.4	0.4	1.4	1.1	0.9
Benchmark															
Impact															
<b>ALTERNATIVES</b>															
Relative Return %															
Fund	7.4	-2.0	0.4	1.7	-0.1	1.4	2.0	2.4	4.0	-0.5	-3.8	1.4	0.9	4.7	4.2
Benchmark	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	3.3	3.3	3.2
Impact	0.6	-0.3	-	0.1	-0.1	0.1	0.1	0.1	0.3	-0.1	-0.5	0.1	-0.3	0.1	0.1
<b>CURRENCY INSTRUMENTS</b>															
Relative Return %															
Fund	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.0 #						
Benchmark															
Impact															
<b>TOTAL PROPERTY</b>															
Relative Return %															
Fund	1.2	1.2	2.0	3.7	2.8	4.7	3.9	4.4	2.6	2.8	3.8	2.3	12.0	12.3	8.4
Benchmark	0.8	1.4	2.4	4.3	3.3	4.3	4.0	4.6	2.8	3.3	3.0	2.8	12.5	12.9	9.2
Impact	-	-	-	-0.1	-	-	-	-	-	-0.1	0.1	-0.1	-	-0.1	-0.1

For each area of investment the return for the Fund and the Benchmark is shown and the relative return plotted.

The impact of stock selection is the relative return weighted by the level of investment in the area.

# not invested in this area for the entire period

- indicates a value less than 0.05 and greater than -0.05

# Rolling Years with Relative Risk

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

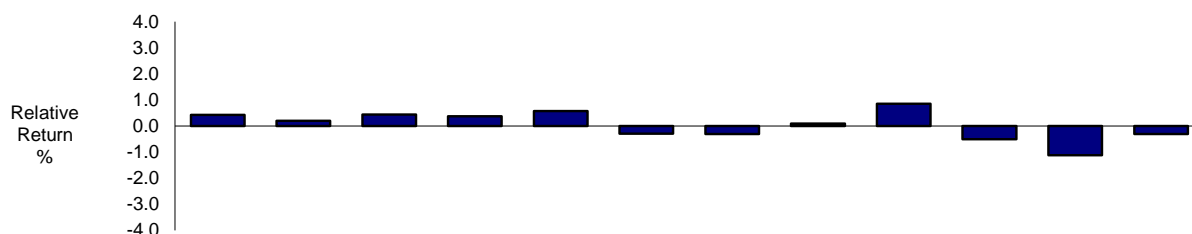
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

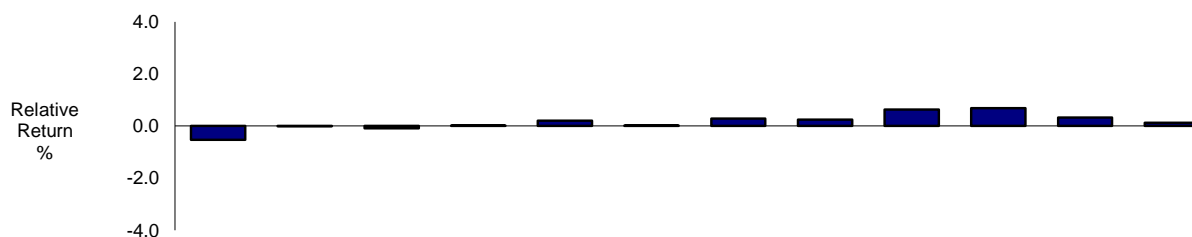
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	853.8	929.4	930.3	956.0	998.4	1016.2	1035.1	1049.7	1081.5	1141.9	1115.6	1071.6
Net Investment	2.2	3.7	0.8	6.2	7.1	4.2	4.3	4.7	2.5	4.8	3.7	3.6
Capital Gain/Loss	73.3	-2.7	24.9	36.2	10.8	14.7	10.3	27.0	57.9	-31.0	-47.7	42.4
Final	929.4	930.3	956.0	998.4	1016.2	1035.1	1049.7	1081.5	1141.9	1115.6	1071.6	1117.7
Income	2.3	3.2	2.3	2.1	2.1	3.8	2.3	2.9	2.0	3.2	2.5	2.5
Proportion Of Total Fund (%)	100	100	100	100	100	100	100	100	100	100	100	100
Proportions (%) In												
Total Equity	63	63	64	65	64	64	63	61	63	60	58	59
Bonds + IL	16	16	15	15	14	14	14	15	14	14	15	14
Cash/ Alts	12	11	11	11	11	11	12	13	13	15	16	15
Property	10	10	10	10	10	11	11	11	10	11	12	12

## Quarterly Returns



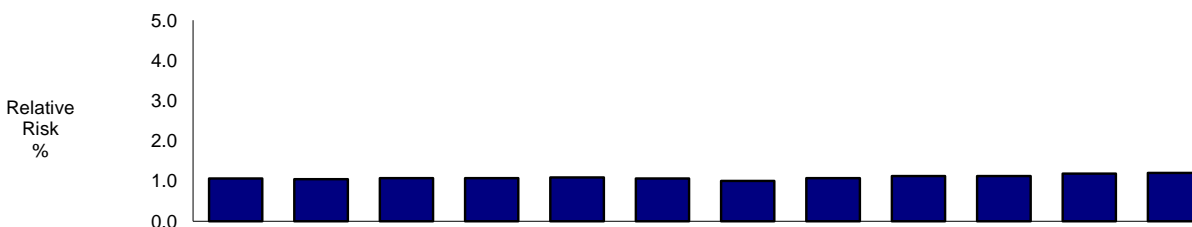
Fund	8.9	0.0	2.9	4.0	1.3	1.8	1.2	2.8	5.5	-2.4	-4.0	4.2
Benchmark	8.4	-0.2	2.5	3.6	0.7	2.1	1.5	2.7	4.7	-1.9	-2.9	4.5
Relative Return	0.4	0.2	0.4	0.4	0.6	-0.3	-0.3	0.1	0.9	-0.5	-1.1	-0.3

## Annualised Rolling 3 Year Returns



Fund	6.6	9.5	7.8	7.1	7.1	7.2	11.2	10.4	10.7	10.7	8.3	8.8
Benchmark	7.1	9.6	7.9	7.1	6.9	7.2	10.9	10.1	10.0	10.0	7.9	8.7
Relative Return	-0.5	-0.0	-0.1	0.0	0.2	0.0	0.3	0.2	0.6	0.7	0.3	0.1

## Rolling 3 Year Risk



Relative Risk	1.1	1.0	1.1	1.1	1.1	1.1	1.0	1.1	1.1	1.1	1.2	1.2
Information Ratio	-0.5	-0.0	-0.1	0.0	0.2	0.0	0.3	0.2	0.6	0.6	0.3	0.1

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

# Summary of Manager Performance

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

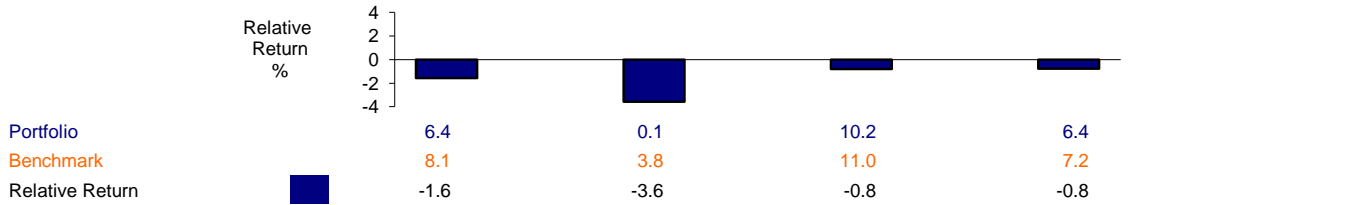
Category - TOTAL ASSETS

This page summarises the performance of each investment manager plotting the return achieved relative to the Benchmark.

	Latest Quarter	1 Year	3 Years % pa	5 Years % pa
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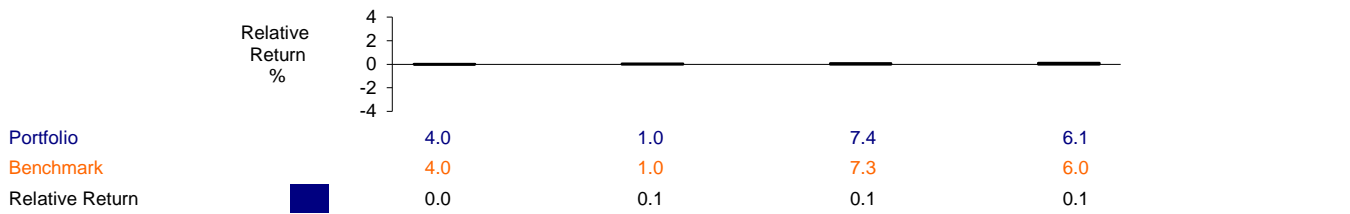
## GMO - TOTAL ASSETS

LB OF TOWER HAMLETS - GMO BM



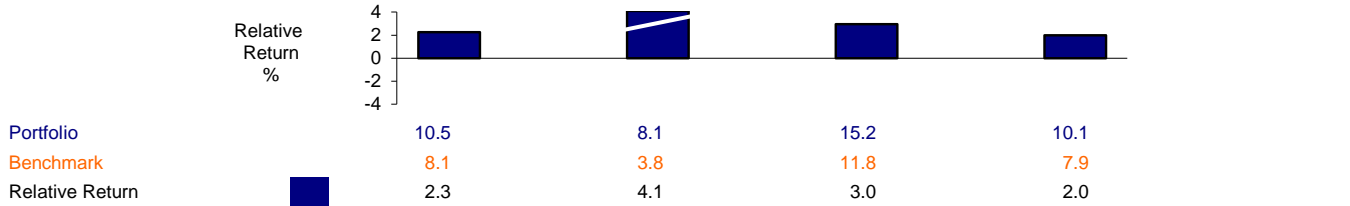
## L&G - TOTAL ASSETS

FTSE All Share TR



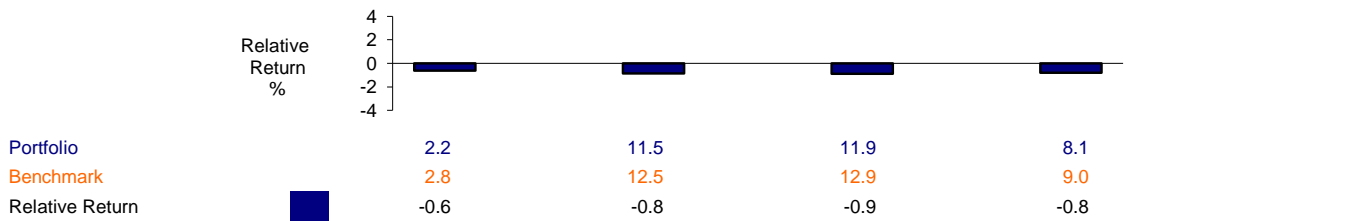
## BAILLIE GIFFORD & CO - TOTAL ASSETS

MSCI AC WORLD GDR



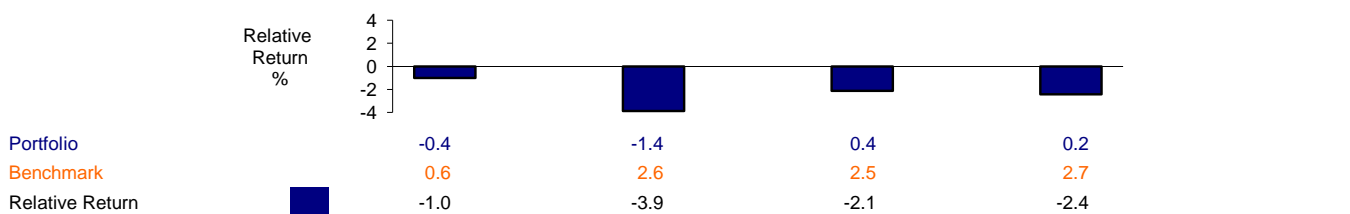
## SCHRODER INVEST. MGMT. - TOTAL ASSETS

London Borough of Tower Hamlets - Schroders



## INVESTEC ASSET MANAGEMENT - TOTAL ASSETS

GBP 3 MONTH LIBOR + 2%



The graphs show the performance of each manager relative to their Benchmark.

The relative return is the degree of out or underperformance of the Benchmark over these periods.

# not invested in this area for the entire period



# Summary of Manager Performance

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

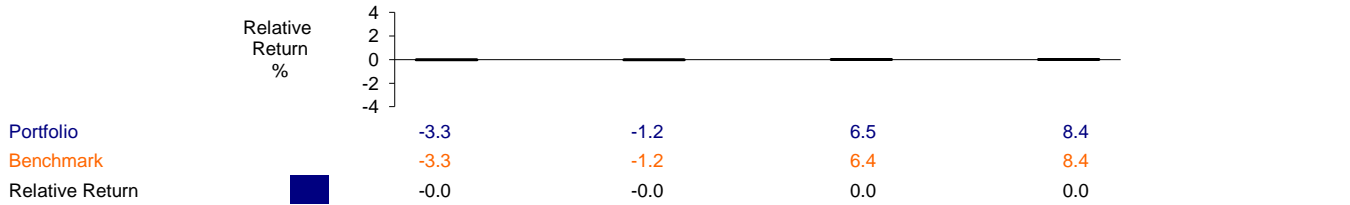
Category - TOTAL ASSETS

This page summarises the performance of each investment manager plotting the return achieved relative to the Benchmark.

	Latest Quarter	1 Year	3 Years % pa	5 Years % pa
--	----------------	--------	-----------------	-----------------

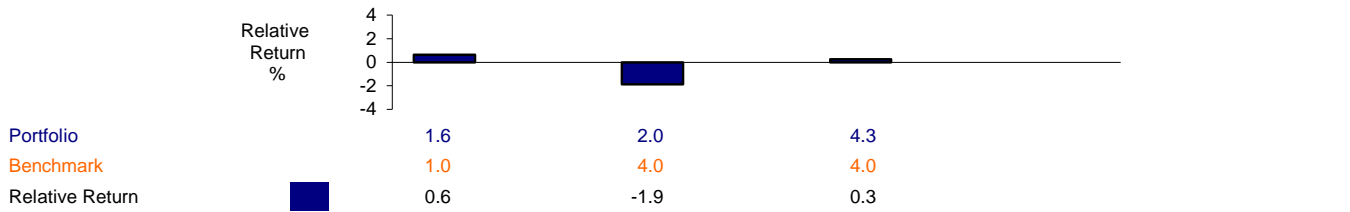
## L&G - TOTAL ASSETS

FTSE UK GILTS INDEXED > 5 YRS



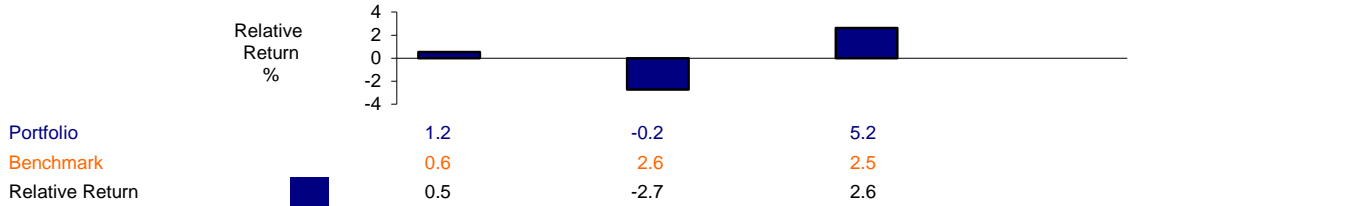
## BAILLIE GIFFORD & CO - TOTAL ASSETS

BANK OF ENGLAND BASE RATE + 3.5%



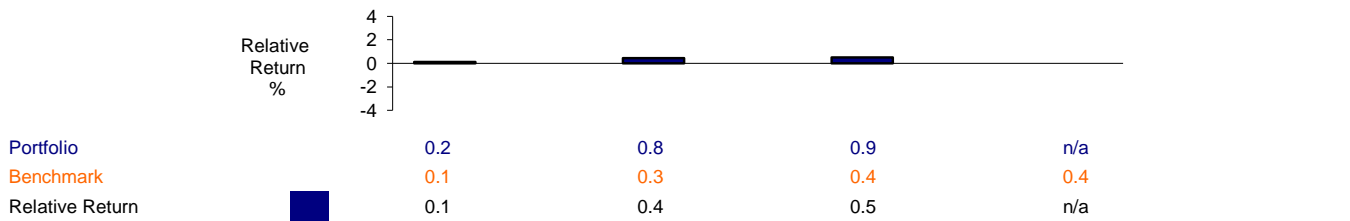
## RUFFER INVESTMENT MGMT LTD - TOTAL ASSETS

GBP 3 MONTH LIBOR + 2%



## INTERNALLY MANAGED - TOTAL ASSETS

LB TOWER HAMLETS INTERNAL BM



Relative Return

The graphs show the performance of each manager relative to their Benchmark.

The relative return is the degree of out or underperformance of the Benchmark over these periods.

# not invested in this area for the entire period

## Performance Summary - Manager Attribution

LONDON BOROUGH OF TOWER HAMLETS  
Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Quarter to end December 2015  
Pound Sterling

This page analyses in detail the contributions to the Fund performance over the latest period.

### Summary

Fund Return	4.2
Benchmark Return	4.5
Relative Performance	-0.3
<b>attributable to:</b>	
Strategic Allocation	-0.3
Manager Contribution	-
Residual	-

The relative performance can be attributed to the effects of manager contribution and strategic allocation.

### Detail

Strategic Allocation			Manager Contribution			
Distribution		Policy	Investment Manager	Weighted Contribution	% Return	
Portfolio	Benchmark	Contribution			Portfolio	Benchmark
21.2	22.6	-	GMO	-0.3	6.4	8.1
19.6	19.6	-	L&G	-	4.0	4.0
17.7	17.7	-	BAILLIE GIFFORD & CO	0.4	10.5	8.1
12.2	13.0	-	SCHRODER INVEST. MGMT.	-0.1	2.2	2.8
9.2	14.1	0.2	INVESTEC ASSET MANAGEMENT	-0.1	-0.4	0.6
5.5	2.9	-0.2	L&G	-	-3.3	-3.3
5.2	5.1	-	BAILLIE GIFFORD & CO	-	1.6	1.0
5.0	5.0	-	RUFFER INVESTMENT MGMT LTD	-	1.2	0.6
4.6	0.0	-0.2	INTERNALLY MANAGED	-	0.2	0.1
		-0.3		-		

The Strategic Allocation quantifies the impact of the fund being invested differently from the Strategic Benchmark set.

The Manager Contribution comes about from the out / underperformance of each manager relative to their benchmarks weighted by the value of assets held.

# = not invested in this area for the entire period

Appendices

# Asset Mix and Returns

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED

Periods to end December 2015

Benchmark - LB TOWER HAMLETS TOTAL B/MARK

Pound Sterling

This page provides the underlying detail for the fund over the latest period.

All values are shown in GBP'000s	Asset Allocation						Stock Selection			
	30/09/2015		Purchases	Sales	Gain/		31/12/2015		Return	B'M
	Value	%			Loss	Income	Value	%		
TOTAL EQUITIES	623,371	58	64,748	64,516	40,992	1,583	664,595	59	6.8	6.7
U.K. EQUITIES	210,051	20	494		8,393	5	218,938	20	4.0	4.0
OVERSEAS EQUITIES	224,039	21	64,139	64,516	12,823	1,578	236,485	21	6.4	8.1
NORTH AMERICA	95,199	9	38,446	29,455	3,973	447	108,163	10	4.3	
TOTAL USA	82,441	8	30,270	23,080	11,017	412	100,649	9	13.4	
CONTINENTAL EUROPE	43,179	4	5,052	12,507	4,277	82	40,002	4	10.8	
EUROLAND TOTAL	37,194	3	3,410	10,862	3,418	64	33,160	3	9.8	
FRANCE	13,327	1	1,983	4,466	1,127	57	11,972	1	9.2	
GERMANY	11,084	1	256	1,474	1,507		11,373	1	13.9	
NETHERLANDS	2,882	0	194	173	203	2	3,107	0	7.2	
ITALY	2,794	0	224	907	66	1	2,177	0	2.0	
BELGIUM	839	0	248	240	102		950	0	15.3	
FINLAND	581	0	123		100		803	0	16.9	
AUSTRIA	551	0	47	123	41		516	0	9.0	
SPAIN	3,345	0	230	2,283	62	4	1,353	0	-0.9	
IRELAND	1,401	0	35	1,134	203	1	505	0	16.2	
PORTUGAL	389	0	70	62	7		404	0	1.5	
NON EUROLAND TOTAL	5,985	1	1,642	1,645	859	18	6,842	1	16.1	
SWITZERLAND	2,241	0	1,513	798	808	4	3,763	0	33.5	
DENMARK	706	0		442	25		289	0	10.6	
NORWAY	1,250	0	122	27	9	14	1,354	0	2.1	
SWEDEN	1,789	0	8	379	17		1,436	0	1.1	
JAPAN	21,632	2	4,207	4,771	2,980	36	24,048	2	14.6	
TOTAL PACIFIC (EX.JAPAN)	14,979	1	7,155	3,746	915	60	19,302	2	6.4	
OTHER INTL EQUITIES	28,730	3	7,480	8,739	-118	772	27,354	2	2.2	8.1
UK GLOBAL	20,319	2	1,799	5,298	796	180	17,616	2	5.1	
GLOBAL POOLED INC UK	189,281	18	115		19,776		209,172	19	10.4	8.1
BG INTERNATIONAL EQUITY FUND	189,281	18	115		19,776		209,172	19	10.4	
OVERSEAS BONDS										
U.K. INDEX - LINKED	58,915	5			-1,945		56,970	5	-3.3	-3.3
POOLED BONDS	98,686	9			-317		98,369	9	-0.3	0.6
CASH/ALTERNATIVES	166,260	16	105,429	105,145	1,656	98	168,200	15	1.1	0.8
CURRENCY INSTRUMENTS										
U.K. PROPERTY	120,933	11	20,127	16,947	2,160	878	126,273	11	2.5	2.8
OVERSEAS PROPERTY	3,470	0	0	61	-160		3,249	0	-4.7	
<b>TOTAL ASSETS</b>	<b>1,071,636</b>	<b>100</b>	<b>190,304</b>	<b>186,669</b>	<b>42,386</b>	<b>2,512</b>	<b>1,117,657</b>	<b>100</b>	<b>4.2</b>	<b>4.5</b>

The change in Fund value over the period is a combination of the net money flows into or out of the Fund and any gain or loss on the capital value of the investments.

# not invested in this area for the entire period

# Summary of Long Term Returns

LONDON BOROUGH OF TOWER HAMLETS - TOTAL COMBINED  
Benchmark - LOCAL AUTHORITY UNIVERSE

Periods to end December 2015  
Pound Sterling

This page summarises the long term returns at asset class level  
A ranking against the peer group is shown in brackets.

Return %	2013				2014				2015				1yr	3yrs % pa	5yrs % pa
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<i>UK Equities</i>	10.3 (78)	-1.5 (48)	5.8 (52)	5.7 (46)	-0.4 (33)	2.7 (12)	-1.2 (68)	0.4 (77)	4.7 (44)	-1.5 (63)	-5.7 (39)	4.0	1.1	7.6	6.3
<i>N. America</i>	14.5 (98)	1.2 (95)	-1.8 (98)	7.4 (58)	1.4 (36)	0.5 (93)	7.0 (6)	8.6 (32)	7.4 (29)	-5.4 (55)	-7.0 (95)	4.3	-1.4	12.6	9.4
<i>Europe ex UK</i>	4.3 (100)	2.9 (6)	11.6 (1)	8.0 (4)	6.5 (1)	1.6 (16)	-5.6 (100)	-2.7 (95)	10.4 (68)	-5.8 (53)	-9.2 (95)	10.8	4.6	10.4	4.9
<i>Pacific</i>	4.2 (96)	-6.5 (17)	7.2 (4)	4.6 (3)	-0.8 (75)	4.4 (13)	0.1 (66)	3.0 (41)	11.1 (19)	-4.9 (14)	-16.1 (82)	6.4	-5.7	3.2	4.4
<i>Japan</i>	18.6 (81)	6.1 (20)	2.1 (22)	-2.4 (92)	-4.8 (27)	6.3 (8)	0.9 (95)	-4.0 (98)	18.5 (10)	-0.1 (12)	-8.5 (42)	14.6	24.0	15.1	6.6
<i>Global Eq</i>	15.8 (20)	1.7 (18)	2.8 (15)	5.1 (50)	2.0 (11)	0.3 (100)	1.9 (73)	6.4 (10)	9.1 (16)	-4.9 (60)	-5.8 (53)	10.4	7.9	15.0	10.0
<i>UK IL</i>	9.0 (27)	-7.3 (51)	0.6 (30)	-0.9 (28)	3.6 (21)	1.1 (34)	5.9 (20)	9.4 (31)	3.3 (29)	-3.3 (59)	2.3 (24)	-3.3	-1.2	6.5	8.4
<i>Pooled Bonds</i>	0.2 (92)	0.1 (33)	-0.3 (78)	0.5 (64)	0.1 (93)	0.0 (76)	1.2 (30)	0.8 (27)	0.1 (91)	-1.1 (80)	0.2 (19)	-0.3	-1.1	0.5	0.3
<i>Cash</i>	1.5 (22)	0.2 (37)	-1.0 (81)	-0.2 (70)	-0.2 (80)	-0.2 (72)	0.8 (23)	0.9 (21)	0.6 (37)	0.0 (50)	0.4 (29)	0.4	1.4	1.1	0.9
<i>Alternatives</i>	7.4 (22)	-2.0 (86)	0.4 (28)	1.7 (39)	-0.1 (86)	1.4 (39)	2.0 (60)	2.4 (53)	4.0 (31)	-0.5 (54)	-3.8 (96)	1.4	0.9	4.7	4.2
<i>Curr Instr</i>	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.0 #						
<i>Property</i>	1.2 (36)	1.2 (77)	2.0 (51)	3.7 (58)	2.8 (61)	4.7 (36)	3.9 (54)	4.4 (25)	2.6 (62)	2.8 (62)	3.8 (14)	2.3	12.0	12.3	8.4
<i>Total Assets</i>	8.9 (60)	0.0 (14)	2.9 (33)	4.0 (32)	1.3 (21)	1.8 (67)	1.2 (86)	2.8 (63)	5.5 (42)	-2.4 (39)	-4.0 (72)	4.2	2.9	8.8	6.3

# not invested in this area for the entire period

# Rolling Years with Relative Risk - GMO World Equity

LONDON BOROUGH OF TOWER HAMLETS - GMO  
 Benchmark - LB OF TOWER HAMLETS - GMO BM

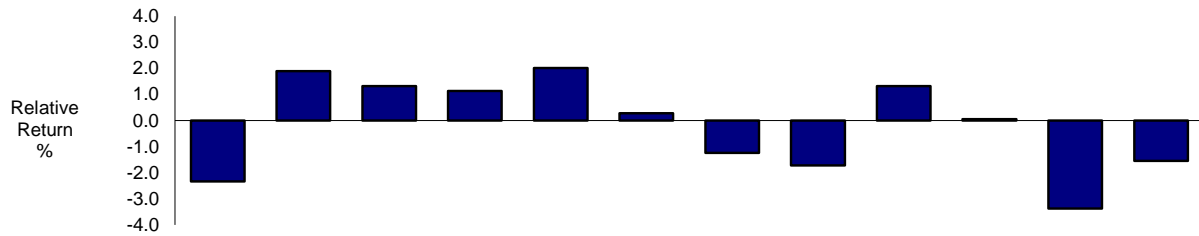
Periods to end December 2015  
 Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

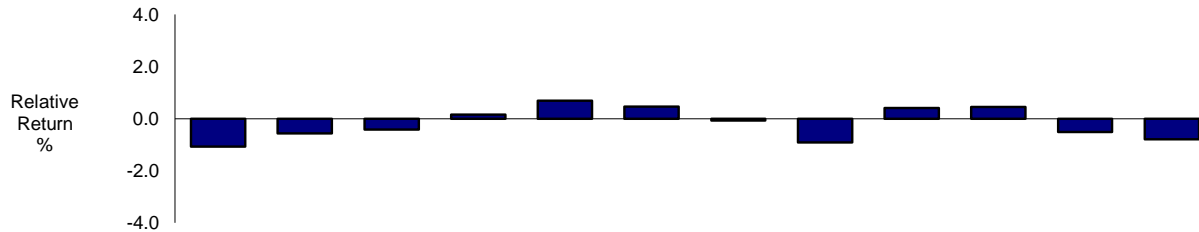
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	203.5	226.3	231.9	241.1	254.8	260.5	267.0	267.8	250.7	273.4	249.2	226.6
Net Investment	0.8	2.7	1.0	1.7	0.9	2.8	1.2	-18.8	1.0	-8.6	1.5	1.8
Capital Gain/Loss	22.0	2.9	8.2	12.0	4.8	3.7	-0.4	1.7	21.6	-15.6	-24.1	13.0
Final	226.3	231.9	241.1	254.8	260.5	267.0	267.8	250.7	273.4	249.2	226.6	241.4
Income	1.3	2.3	1.3	1.3	1.2	2.7	1.3	1.9	1.0	2.1	1.5	1.5
Proportion Of Total Fund (%)	24	25	25	26	26	26	26	23	24	22	21	22

## Quarterly Returns



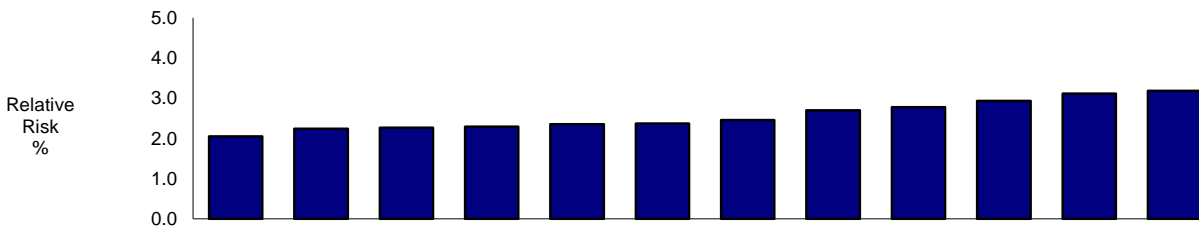
Fund	11.4	2.3	4.1	5.5	2.4	2.4	0.3	1.3	9.0	-5.1	-9.0	6.4
Benchmark	14.1	0.4	2.7	4.3	0.3	2.2	1.6	3.1	7.6	-5.1	-5.9	8.1
Relative Return	-2.3	1.9	1.3	1.1	2.0	0.3	-1.2	-1.7	1.3	0.1	-3.4	-1.6

## Annualised Rolling 3 Year Returns



Fund	6.3	11.4	9.3	8.4	8.5	8.7	14.8	13.0	14.1	13.8	9.1	10.2
Benchmark	7.5	12.0	9.8	8.3	7.8	8.2	14.9	14.0	13.6	13.3	9.7	11.0
Relative Return	-1.1	-0.6	-0.4	0.1	0.7	0.5	-0.1	-0.9	0.4	0.4	-0.5	-0.8

## Rolling 3 Year Risk



Relative Risk	2.0	2.2	2.3	2.3	2.4	2.4	2.5	2.7	2.8	2.9	3.1	3.2
Information Ratio	-0.5	-0.3	-0.2	0.1	0.3	0.2	-0.0	-0.3	0.1	0.2	-0.2	-0.3

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

# Rolling Years with Relative Risk - L&G Equity Uk

LB OF TOWER HAMLETS - L&G  
Benchmark - FTSE All Share TR

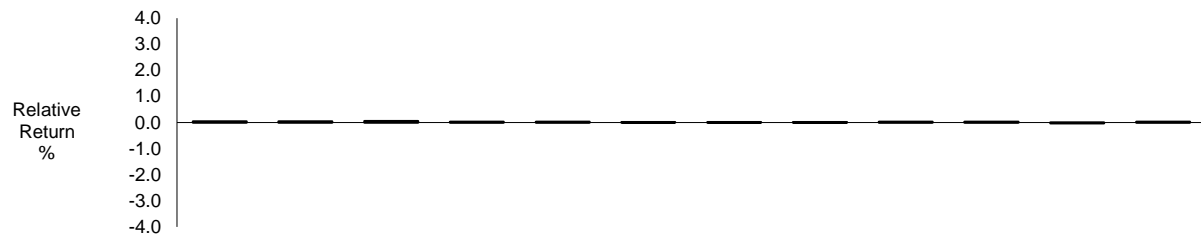
Periods to end December 2015  
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

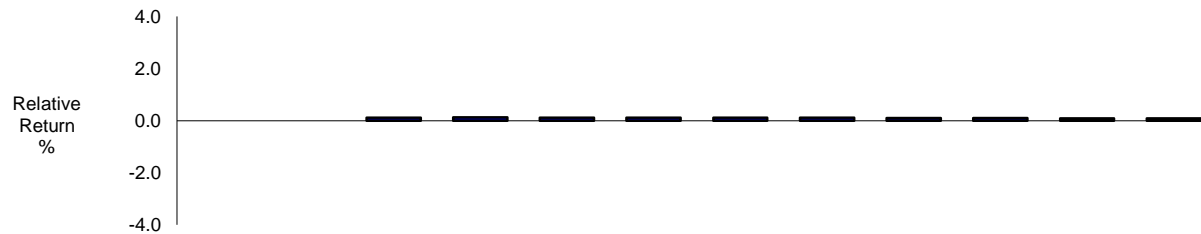
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	176.3	194.6	191.5	202.3	213.4	212.1	216.9	214.8	216.1	226.3	222.8	210.1
Net Investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital Gain/Loss	18.3	-3.1	10.8	11.1	-1.3	4.8	-2.1	1.3	10.2	-3.5	-12.7	8.4
Final	194.6	191.5	202.3	213.4	212.1	216.9	214.8	216.1	226.3	222.8	210.1	218.4
Income	0.0	0.0	0.0	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0
Proportion Of Total Fund (%)	21	21	21	21	21	21	20	20	20	20	20	20

## Quarterly Returns



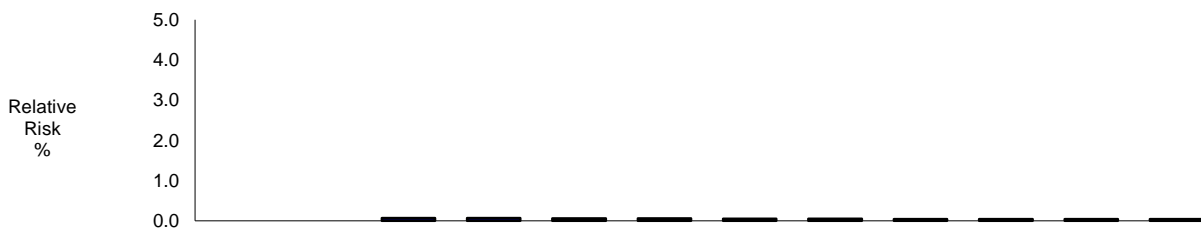
Fund	10.4	-1.6	5.6	5.5	-0.6	2.3	-1.0	0.6	4.7	-1.5	-5.7	4.0
Benchmark	10.3	-1.7	5.6	5.5	-0.6	2.2	-1.0	0.6	4.7	-1.6	-5.7	4.0
Relative Return	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.0	0.0

## Annualised Rolling 3 Year Returns



Fund		10.2	9.5	8.9	9.0	14.1	11.2	10.7	11.1	7.3	7.4
Benchmark		10.1	9.4	8.8	8.9	13.9	11.1	10.6	11.0	7.2	7.3
Relative Return		0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

## Rolling 3 Year Risk



Relative Risk		0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Information Ratio		1.7	1.9	1.9	2.2	2.2	2.3	2.3	2.2	2.1	2.4

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

# Rolling Years with Relative Risk - B Gifford World Equity

LONDON BOROUGH OF TOWER HAMLETS - BAILLIE GIFFORD & CO

Periods to end December 2015

Benchmark - MSCI AC WORLD GDR

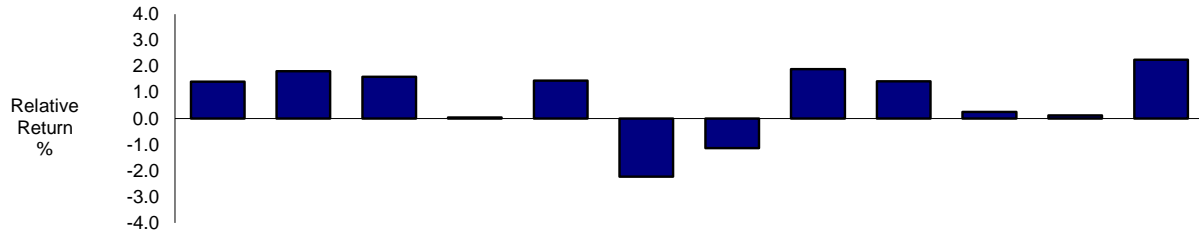
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

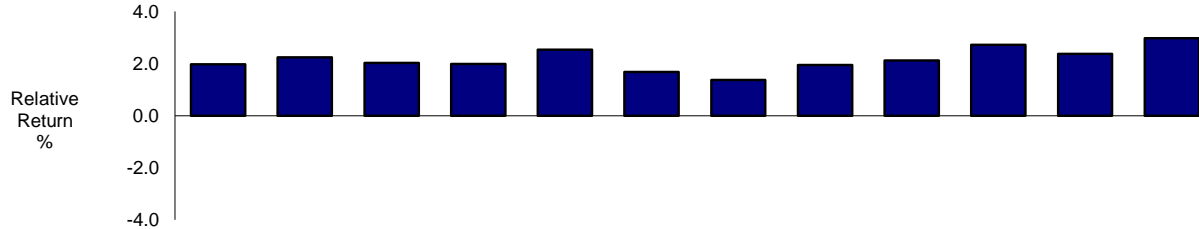
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	140.8	163.1	165.9	170.6	179.4	183.1	183.6	187.3	199.4	217.7	200.8	189.3
Net Investment	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-6.3	0.1	0.1
Capital Gain/Loss	22.2	2.8	4.6	8.6	3.6	0.5	3.5	12.1	18.1	-10.5	-11.7	19.8
Final	163.1	165.9	170.6	179.4	183.1	183.6	187.3	199.4	217.7	200.8	189.3	209.2
Income	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Proportion Of Total Fund (%)	18	18	18	18	18	18	18	18	19	18	18	19

## Quarterly Returns



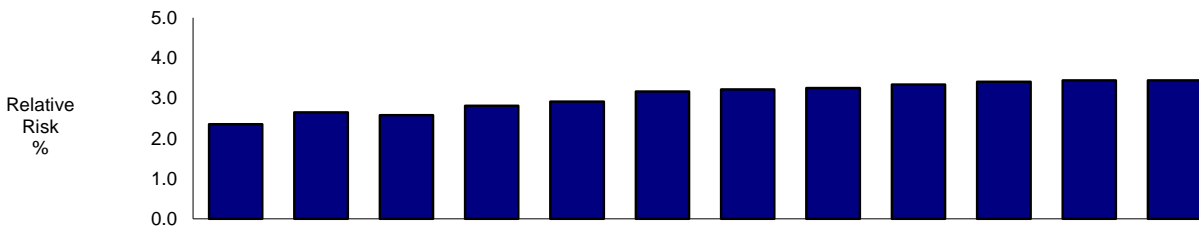
Fund	15.8	1.7	2.8	5.1	2.0	0.3	2.0	6.5	9.1	-4.9	-5.8	10.5
Benchmark	14.1	-0.1	1.2	5.0	0.5	2.6	3.2	4.5	7.6	-5.1	-5.9	8.1
Relative Return	1.4	1.8	1.6	0.0	1.5	-2.2	-1.1	1.9	1.4	0.2	0.1	2.3

## Annualised Rolling 3 Year Returns



Fund	10.5	15.0	12.0	10.4	10.4	10.4	17.3	16.8	16.5	16.6	12.4	15.2
Benchmark	8.3	12.5	9.8	8.3	7.7	8.5	15.7	14.6	14.1	13.5	9.8	11.8
Relative Return	2.0	2.2	2.0	2.0	2.5	1.7	1.4	1.9	2.1	2.7	2.4	3.0

## Rolling 3 Year Risk



Relative Risk	2.3	2.6	2.6	2.8	2.9	3.2	3.2	3.2	3.3	3.4	3.4	3.4
Information Ratio	0.8	0.8	0.8	0.7	0.9	0.5	0.4	0.6	0.6	0.8	0.7	0.9

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.



# Rolling Years with Relative Risk - Schroders UK Property

LB OF TOWER HAMLET PROPERTY PORTFOLIO - SCHRODER INVEST. MGMT.

Periods to end December 2015

Benchmark - London Borough of Tower Hamlets - Schroders

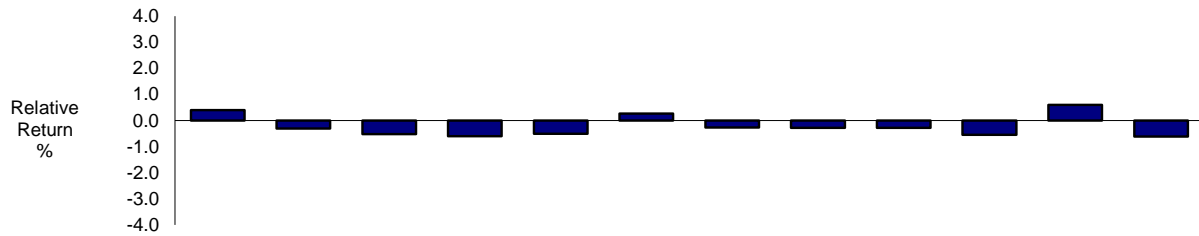
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

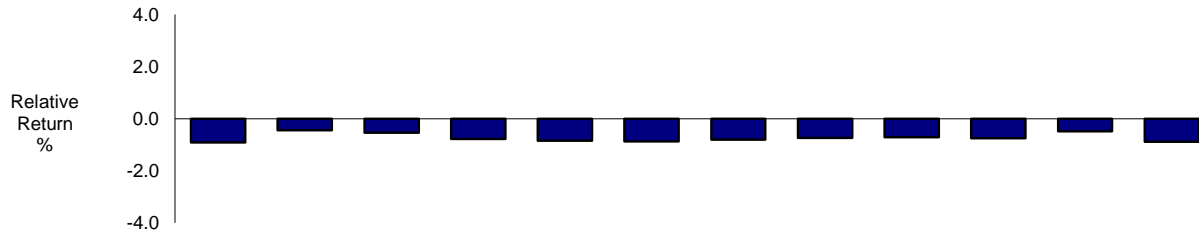
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	94.7	95.8	96.8	98.7	102.3	105.2	110.1	114.3	119.2	122.2	125.6	130.1
Net Investment	0.9	0.8	0.9	0.8	1.0	1.1	1.0	1.0	0.9	0.9	0.9	0.9
Capital Gain/Loss	0.1	0.3	0.9	2.8	1.9	3.8	3.2	3.9	2.1	2.4	3.6	2.0
Final	95.8	96.8	98.7	102.3	105.2	110.1	114.3	119.2	122.2	125.6	130.1	133.0
Income	1.0	0.8	0.9	0.8	0.9	1.0	0.9	0.9	0.9	0.9	0.9	0.9
Proportion Of Total Fund (%)	10	10	10	10	10	11	11	11	11	11	12	12

## Quarterly Returns



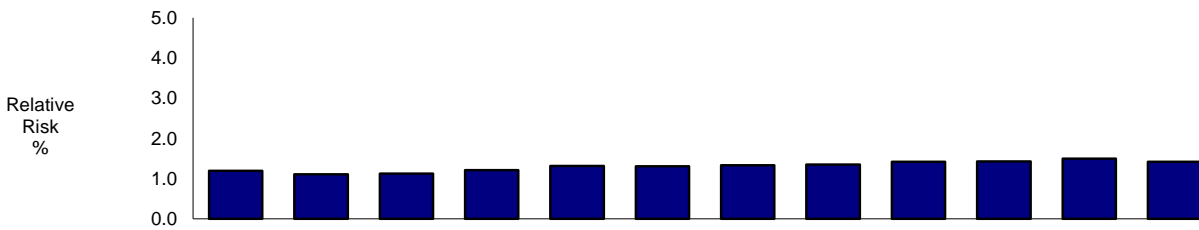
Fund	1.2	1.1	1.9	3.6	2.8	4.6	3.7	4.3	2.5	2.8	3.6	2.2
Benchmark	0.8	1.4	2.4	4.3	3.3	4.3	4.0	4.6	2.8	3.3	3.0	2.8
Relative Return	0.4	-0.3	-0.5	-0.6	-0.5	0.3	-0.3	-0.3	-0.3	-0.5	0.6	-0.6

## Annualised Rolling 3 Year Returns



Fund	3.8	3.7	3.9	4.4	4.8	5.7	6.6	7.8	8.6	9.7	11.1	11.9
Benchmark	4.7	4.2	4.4	5.2	5.7	6.6	7.4	8.6	9.4	10.6	11.7	12.9
Relative Return	-0.9	-0.4	-0.5	-0.8	-0.8	-0.9	-0.8	-0.7	-0.7	-0.7	-0.5	-0.9

## Rolling 3 Year Risk



Relative Risk	1.2	1.1	1.1	1.2	1.3	1.3	1.3	1.4	1.4	1.4	1.5	1.4
Information Ratio	-0.8	-0.4	-0.5	-0.7	-0.6	-0.7	-0.6	-0.5	-0.5	-0.5	-0.3	-0.6

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

# Rolling Years with Relative Risk - Investec Global Bonds

LONDON BOROUGH OF TOWER HAMLETS - INVESTEC ASSET MANAGEMENT

Periods to end December 2015

Benchmark - GBP 3 MONTH LIBOR + 2%

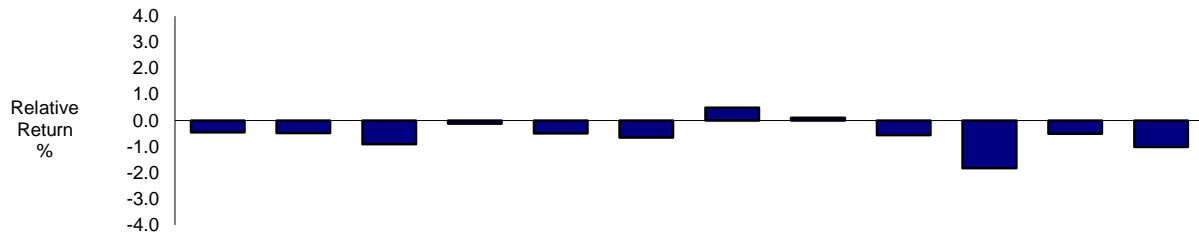
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

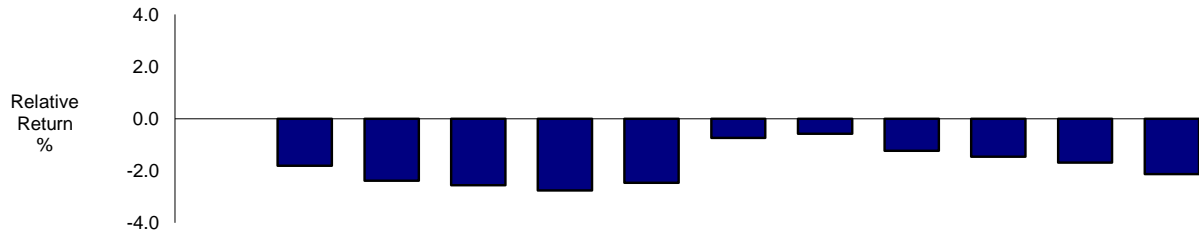
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	96.9	97.0	97.2	96.9	97.4	97.5	97.5	98.7	99.5	99.6	98.5	98.7
Net Investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital Gain/Loss	0.2	0.1	-0.3	0.5	0.1	0.0	1.2	0.8	0.1	-1.1	0.2	-0.3
Final	97.0	97.2	96.9	97.4	97.5	97.5	98.7	99.5	99.6	98.5	98.7	98.4
Income	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Proportion Of Total Fund (%)	10	10	10	10	10	9	9	9	9	9	9	9

## Quarterly Returns



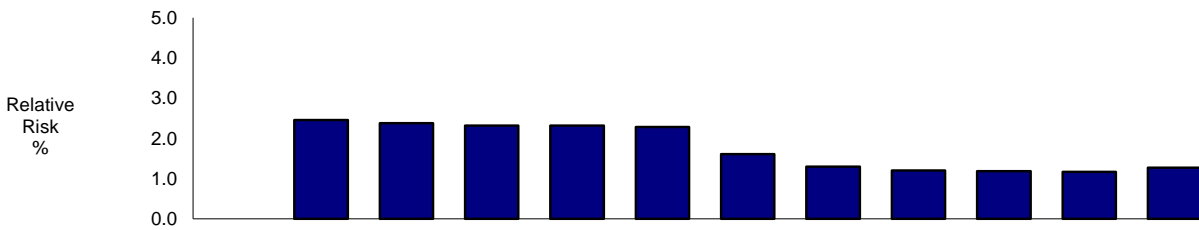
Fund	0.2	0.1	-0.3	0.5	0.1	-0.0	1.1	0.7	0.1	-1.2	0.1	-0.4
Benchmark	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Relative Return	-0.5	-0.5	-0.9	-0.1	-0.5	-0.7	0.5	0.1	-0.6	-1.8	-0.5	-1.0

## Annualised Rolling 3 Year Returns



Fund	0.9	0.3	0.1	-0.1	0.2	1.9	2.0	1.3	1.1	0.8	0.4	0.4
Benchmark	2.8	2.8	2.7	2.7	2.7	2.7	2.6	2.6	2.5	2.5	2.5	2.5
Relative Return	-1.8	-2.4	-2.6	-2.8	-2.5	-0.7	-0.6	-1.2	-1.5	-1.7	-2.1	-2.1

## Rolling 3 Year Risk



Relative Risk	2.5	2.4	2.3	2.3	2.3	1.6	1.3	1.2	1.2	1.2	1.2	1.3
Information Ratio	-0.7	-1.0	-1.1	-1.2	-1.1	-0.5	-0.5	-1.0	-1.2	-1.4	-1.7	-1.7

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

# Rolling Years with Relative Risk - L&G Index Linked

LB OF TOWER HAMLETS - L&G

Periods to end December 2015

Benchmark - FTSE UK GILTS INDEXED > 5 YRS

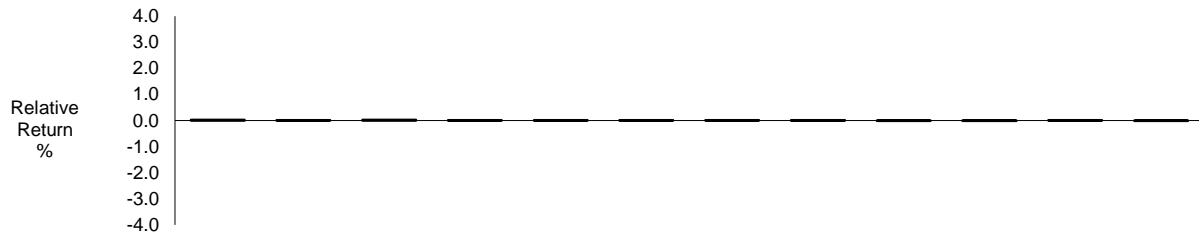
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

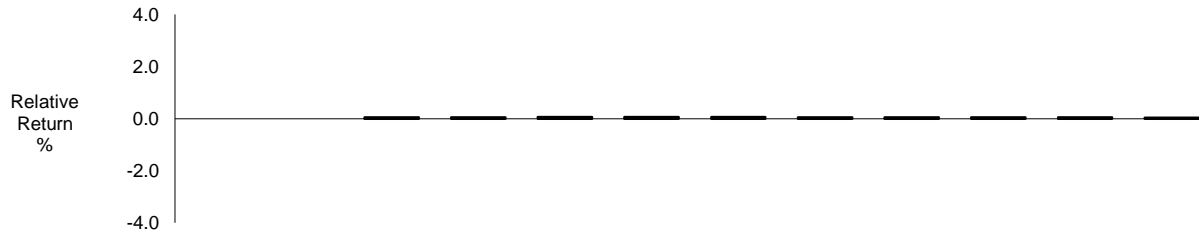
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	47.2	51.4	47.6	47.9	47.5	49.2	49.7	52.7	57.7	59.5	57.6	58.9
Net Investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital Gain/Loss	4.3	-3.8	0.3	-0.4	1.7	0.6	3.0	5.0	1.9	-2.0	1.3	-1.9
Final	51.4	47.6	47.9	47.5	49.2	49.7	52.7	57.7	59.5	57.6	58.9	57.0
Income	0.0	0.0	0.0	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0
Proportion Of Total Fund (%)	6	5	5	5	5	5	5	5	5	5	5	5

### Quarterly Returns



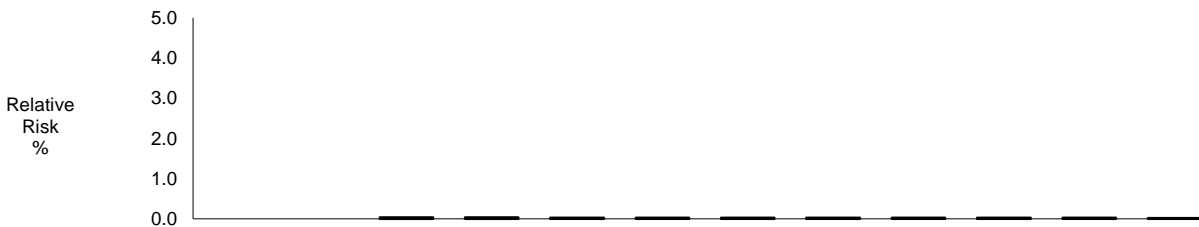
Fund	9.0	-7.3	0.6	-0.9	3.6	1.1	5.9	9.4	3.3	-3.3	2.3	-3.3
Benchmark	9.0	-7.3	0.5	-0.9	3.6	1.1	5.9	9.4	3.3	-3.3	2.3	-3.3
Relative Return	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.0	-0.0	0.0	-0.0

### Annualised Rolling 3 Year Returns



Fund			8.4	7.7	9.0	7.8	7.2	7.1	9.0	7.5	9.4	6.5
Benchmark			8.3	7.6	8.9	7.8	7.1	7.0	8.9	7.4	9.4	6.4
Relative Return			0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0

### Rolling 3 Year Risk



Relative Risk			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Information Ratio			1.5	1.6	2.1	2.5	2.8	2.7	2.7	2.2	2.3	1.9

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

# Rolling Years with Relative Risk - B Gifford Divers Growth

LB OF TOWER HAMLETS - BAILLIE GIFFORD & CO

Periods to end December 2015

Benchmark - BANK OF ENGLAND BASE RATE + 3.5%

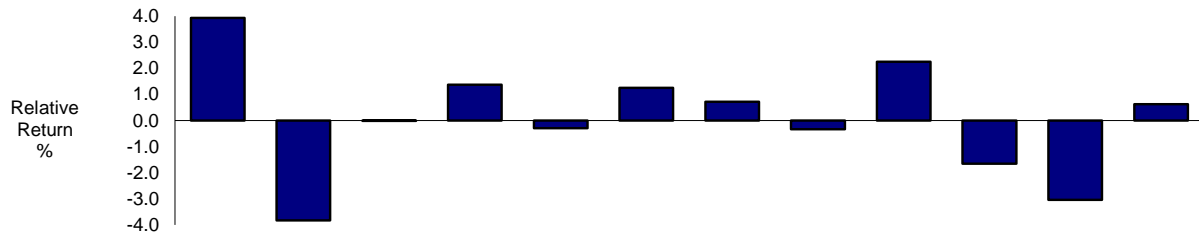
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

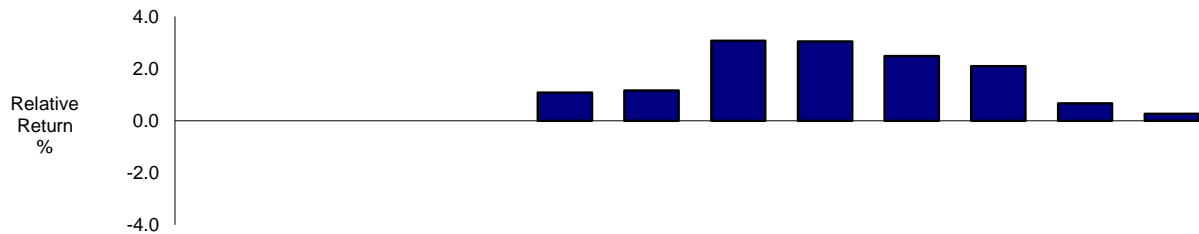
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	44.1	46.3	45.0	45.5	46.5	46.9	47.9	48.8	49.1	50.7	56.7	55.5
Net Investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.4	0.0	0.0
Capital Gain/Loss	2.2	-1.3	0.4	1.1	0.3	1.0	0.8	0.3	1.6	-0.5	-1.2	0.9
Final	46.3	45.0	45.5	46.5	46.9	47.9	48.8	49.1	50.7	56.7	55.5	56.4
Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Proportion Of Total Fund (%)	5	5	5	5	5	5	5	5	4	5	5	5

### Quarterly Returns



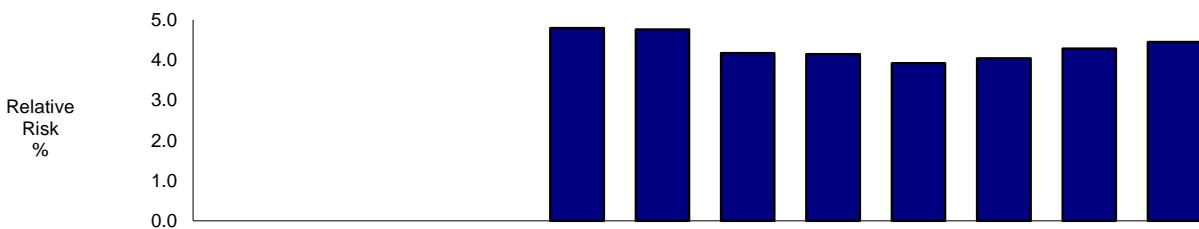
Fund	5.0	-2.9	1.0	2.4	0.7	2.3	1.7	0.6	3.3	-0.7	-2.1	1.6
Benchmark	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Relative Return	3.9	-3.8	-0.0	1.4	-0.3	1.3	0.7	-0.3	2.3	-1.7	-3.0	0.6

### Annualised Rolling 3 Year Returns



Fund	5.1	5.2	7.2	7.2	6.6	6.2	4.7	4.3
Benchmark	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Relative Return	1.1	1.2	3.1	3.0	2.5	2.1	0.7	0.3

### Rolling 3 Year Risk



Relative Risk	4.8	4.8	4.2	4.1	3.9	4.0	4.3	4.4
Information Ratio	0.2	0.2	0.7	0.7	0.6	0.5	0.2	0.1

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

# Rolling Years with Relative Risk - Ruffer

LB OF TOWER HAMLETS - RUFFER INVESTMENT MGMT LTD

Periods to end December 2015

Benchmark - GBP 3 MONTH LIBOR + 2%

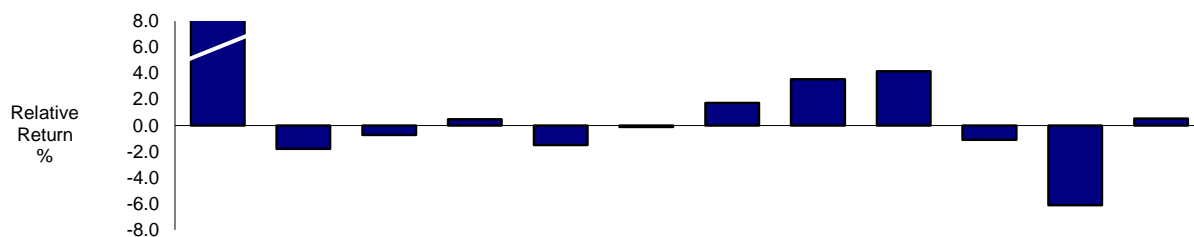
Pound Sterling

## Category - TOTAL ASSETS

This page details the longer term performance of the Fund, plotting it relative to the Benchmark set.

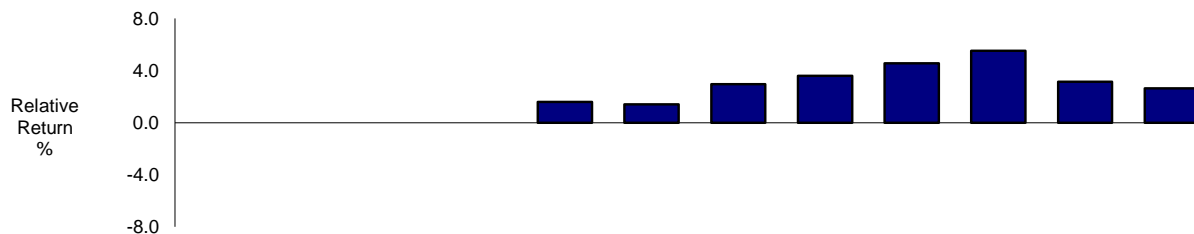
	2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Values (GBPm's)												
Initial	41.3	45.5	45.0	44.9	45.4	45.0	45.3	46.3	48.3	50.6	56.8	53.7
Net Investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.5	0.0	0.0
Capital Gain/Loss	4.2	-0.5	-0.0	0.5	-0.4	0.2	1.1	1.9	2.3	-0.3	-3.1	0.6
Final	45.5	45.0	44.9	45.4	45.0	45.3	46.3	48.3	50.6	56.8	53.7	54.3
Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Proportion Of Total Fund (%)	5	5	5	5	4	4	4	4	4	5	5	5

## Quarterly Returns



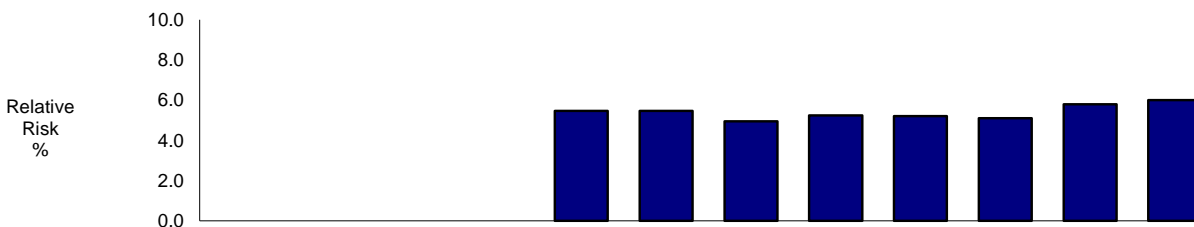
Fund	10.1	-1.2	-0.1	1.1	-0.9	0.5	2.4	4.2	4.8	-0.5	-5.5	1.2
Benchmark	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Relative Return	9.4	-1.8	-0.7	0.5	-1.5	-0.1	1.7	3.5	4.2	-1.1	-6.1	0.5

## Annualised Rolling 3 Year Returns



Fund	4.3	4.1	5.7	6.3	7.2	8.2	5.8	5.2
Benchmark	2.7	2.7	2.7	2.6	2.6	2.5	2.5	2.5
Relative Return	1.6	1.4	3.0	3.6	4.5	5.5	3.1	2.6

## Rolling 3 Year Risk




Relative Risk	5.5	5.5	4.9	5.2	5.2	5.1	5.8	6.0
Information Ratio	0.3	0.3	0.6	0.7	0.9	1.1	0.5	0.4

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

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<p>Non-Executive Report of the:  <b>PENSIONS COMMITTEE</b>  <b>9 March 2016</b></p>	
<p><b>Report of:</b> Zena Cooke, Corporate Director of Resources</p>	<p><b>Classification:</b> Unrestricted</p>
<p><b>Collaboration Work Update –National LGPS Procurement Framework and London Collective Investment Vehicle (CIV)</b></p>	

<p><b>Originating Officer(s)</b></p>	<p>Bola Tobun, Investment and Treasury Manager</p>
<p><b>Wards affected</b></p>	<p>All</p>

## Summary

This report provides the Committee with an update on the progress of the Collective Investment Vehicle (CIV) being set up by local government funds in London in collaboration with London Councils.

It also provides an update on the progress of the National LGPS Procurement Frameworks, in which the Fund is involved.

## Recommendations:

Members of the Pensions Committee are asked to:

- Formally agree the fund participation in the re-letting of National LGPS Framework for Actuarial, Benefits & Governance Consultancy Services and the Investment Consultancy Services.
- Note the progress made to date in the re-letting of National LGPS Framework for Actuarial & Benefits Consultancy Services and the Investment Consultancy Services.
- Note the progress on implementation and fund launch of London CIV.

## **1. REASONS FOR THE DECISIONS**

- 1.1 Members are being asked to formally agree the Fund participation in the re-letting of the National LGPS Procurement Framework as it is expected that having this framework in place will afford an improve buying power, procurement efficiency and significant amount of cost savings.
- 1.2 This will allow all LGPS Funds in the UK quicker and more efficient access to high-quality pension fund services by removing the need to independently undertake a full European Union (OJEU) equivalent procurement. The greater interest the framework can demonstrate when it goes to the market, the better the delivery outcome would be.
- 1.3 Any costs associated with delivering this frame work are immaterial in the context of the benefits that will accrue to the Fund. The actuarial framework will have two income streams. The first of which is a joiners' fee, any fund that wishes to use the framework will pay a one off fee. The joiners' fee will be agreed with all founders prior to the launch of the framework. This income stream lasts until the framework closes for business. The second income stream is a Management Rebate, which is paid by suppliers. This is a percentage (currently 1% on all other frameworks) that is paid to the National Frameworks on all invoiced spend. This income stream continues until the last contract let through the framework comes to an end.
- 1.4 The cost of managing the frameworks are covered by these income streams. Surplus income is then used to repay the founder authorities set up costs. If there is any further surplus the founder authorities will agree how best to use this money.

## **2. ALTERNATIVE OPTIONS**

- 2.1 To independently undertake a full European Union (OJEU) equivalent procurement for services, this can be long, painstaking and expensive.

## **3. DETAILS OF REPORT**

### **National LGPS Procurement Framework**

- 3.1 The National LGPS Frameworks procurement initiative was named 'Best Collaboration' at the prestigious LGC Investment Awards, November 2015. The award comes amid increasing pressure on Local Government Pension Scheme (LGPS) Funds to join forces in order to cut costs and pay down deficits.
- 3.2 This project has delivered demonstrable savings, and will deliver future savings" said the LGC judges "It is so far ahead of others." The frameworks are already proving their worth in terms of procurement efficiency and buying power, with measured savings of over £16 million so far. "So many Funds are benefitting from this collaboration" said Nicola Mark, Chair of the National LGPS Framework group "With over half of LGPS Funds engaging with the



frameworks, they are rapidly becoming ‘the norm’ for procurement across the LGPS.”

- 3.3 A ground-breaking collaboration between several LGPS Funds, the frameworks enable the LGPS to leverage its combined buying power while crucially still supporting local decision making and service requirements. The frameworks allow all LGPS Funds in the UK quicker and more efficient access to high-quality pension fund services by removing the need to independently undertake a full European Union (OJEU) equivalent procurement. All participating Funds benefit from pre-agreed Terms and Conditions and ceiling prices established under the frameworks, along with a collaborative rebate.
- 3.4 The Department of Communities and Local Government (DCLG) have recognised “there are clear advantages and savings to making use of the National LGPS Frameworks. Funds should give serious consideration to making greater use of these frameworks.” The project continues to develop to support the Government’s agenda for cost saving reform of LGPS investments.
- 3.5 The National LGPS Frameworks operate on a ‘not for profit’, self-funding model - ‘by LGPS Funds, for LGPS Funds’. No Fund takes a profit from other Funds and all LGPS Funds and employing authorities using the frameworks benefit equally from the collaboration – all benefits are retained in the LGPS.
- 3.6 The procurement services currently available under the National LGPS Frameworks are; Global custodian, Actuarial, Governance and Benefit Consultancy Services, Investment Consultancy Services and Legal Services. The recently launched Legal Services framework is not only open for all LGPS Funds and employing authorities nationally, but for wider public sector pension bodies too. Funds can use the framework to procure legal services matched to their own specific requirements; from small, one-off pieces of work to longer-term, single supplier arrangements.
- 3.7 Accessing legal advice can be difficult for LGPS Funds, particularly those that don’t regularly need these services and may be unfamiliar with the marketplace. The National LGPS Framework for Legal Services offers an easy procurement route to a range of specialist, qualified legal services providers, chosen for their specific pensions and investment expertise.
- 3.8 One of the officers of the Fund currently working closely with a number of other LGPS fund officers to develop re-letting of some services under the national procurement framework.
- 3.9 Current frameworks under development include the re-letting of the actuarial, benefits & governance consultancy and investment consultancy frameworks as they are nearing the end of the 4 year framework lifespan. In addition the Environmental, Social and Governance (ESG) Framework is currently being developed and it is anticipated that this framework will be available for call off by early summer 2016. This is likely to offer a number of lots, which funds will be able to call off including voting services, governance overlay and research work.

- 3.10 It is anticipated that work will also commence shortly on the formation of a framework for third party administration services. Consideration is also being given by the National Frameworks for the establishment of a passive fund manager framework and a transition manager framework.
- 3.11 The Fund has been a keen proponent of collaborative working believing that this will deliver benefits to the Fund not just in terms of financial savings but also delivering wider governance benefits.

### **London CIV**

- 3.12 London CIV is currently undergoing Implementation and fund launch process, termed Phase 1 – which is being delivered through what has become known as the “commonality” strategy. This broadly involves seeking to aggregate borough investments where two or more boroughs are invested with the same investment manager in the same or a very similar mandate, the aim being to increase efficiency and drive down cost.
- 3.13 The commonality strategy is a pragmatic approach that quickly delivers scale benefits for the boroughs and fee income for London CIV to cover operating costs. Phase 1 is the prime focus of activity in terms of fund opening through the first half of 2016.
- 3.14 Implementation of the strategy began with the analysis of investment data gathered from across the boroughs in 2014, the aim of which was to discover which Investment Managers (IMs) the boroughs were invested through, in what asset classes and the underlying mandate strategies. This analysis showed that the 33 funds had holdings with close to 90 IMs through around 250 separate mandates. It also showed that while there was significant commonality in some asset classes (e.g. passive equity) other classes (e.g. fixed income) showed a high degree of dispersion.
- 3.15 Early discussions were held with 14 IMs where commonality could be seen, but over time, as the detail was explored, all but four decided to drop out of the process or were discounted. There were several influencing factors for this, the most prevalent of which was capacity constraint, but also included an unwillingness to reduce fees, especially for those IMs that have a ‘most favoured nation’ clause in their mandates.
- 3.16 In summary, the launch phase will deliver nine sub-funds:
- 2 x UK passive equity
  - 2 x World Developed ex UK passive equity
  - 2 x Emerging Markets passive equity
  - 1 x Diversified Growth Fund (hard closed but nonetheless delivering lower fees for the boroughs currently invested)
  - 2 x Global active equity
- 3.17 In aggregate, the Phase 1 sub-funds will account for £6.1bn, or around 23% of the boroughs’ total assets under management and will involve 20 of the 31 participating authorities. Total fee savings are estimated to be a minimum of £2.8 million per annum (simply through reduced IM Annual Management Charges (AMC)) but could be £3 million or more per annum based on

assumptions about additional benefit derived from the tax efficient nature of the ACS Fund structure. These fee savings will not be spread equally across all the boroughs and this is largely influenced by each borough's current fee position – some boroughs have negotiated better fees than others at this point.

- 3.18 It should be noted that since passively managed equities generally have low fee scales, the ratio of fee savings to assets under management (“AUM”) will increase as the more ‘alternative’ investments such as property and private equity are brought onto the fund.
- 3.19 In addition to the fee charged by each IM the London CIV will also apply a fee to each sub-fund as part of the company's cost recovery. These charges are applied at a rate appropriate to the nature of each sub-fund and range from 0.005% for the UK passive equity funds to 0.025% for the active funds.

### **Phase 2 – Establishing London CIV and developing the ACS Fund**

- 3.20 The strategy for Phase 2, which has already commenced but with implementation starting in 2016-17, falls into two categories:
  - i. Revisiting the Phase I ‘commonality’ strategy with those IMs that had early discussions but did not progress; and
  - ii. Beginning the process of developing the fund with new manager selections in new asset classes.
- 3.21 In addition, the original nine launch sub-funds will be opened to investment from ‘new’ investors enabling any of the 11 boroughs (and indeed any other LGPS Fund) not included in the launch phase to transition assets from their current holdings should they wish to.
- 3.22 Appendix 1 attached to this report presents analysis of the boroughs’ current allocation by asset class, and from this it can be seen that the major asset classes by AUM are equities (active and passive), fixed income (active and passive) and multi-asset.
- 3.23 Category (i) will essentially follow the same process as was described in Phase 1 and will be applied to four Multi-Asset managers and, subject to on-going discussions with IMs and potentially one further passive equity manager. The Multi-Asset products are significantly diverse, and therefore it is sensible to present a fairly wide range of choice to the boroughs so that they can select a strategy which fits their particular risk appetite and investment strategy.
- 3.24 Category (ii) is driven by analysis of the borough's current holdings and the need to build AUM to deliver fee income that supports London CIV's operating costs. By reference to Appendix 1 it is clear that the focus should be on targeting the remainder of the passive and active equity assets and opening initial opportunities for Fixed Income sub-funds.
- 3.25 Passive Fixed Income mandates will be targeted in 2Q 2016-17. Earlier data collected from the boroughs suggests that the Fixed Income asset class has little in the way of commonality and conviction, so on current projections there may be approximately £500 million being transitioned each for Active and Passive. However, the active fixed income mandates are likely to require

more intensive search and selection, and therefore the bulk of the fixed income mandates will fall into the Phase 3 category.

- 3.26 It is anticipated that every participating borough will have opportunities to migrate to the CIV by March 2017.
- 3.27 As currently planned Phase 2 will conclude by March 2018. In terms of AUM, the end of Phase 2 will deliver an estimated £19 billion or 70 per cent of borough assets. However, it should be noted that the opening of sub-funds is complex and time consuming and growth at that pace cannot be guaranteed.
- 3.28 The CIV's first sub-fund was launched before the end of 2015. This was a relatively small active global equities fund with three boroughs currently invested with the Fund Manager - Allianz.
- 3.29 The London CIV's aim is to open the remaining eight sub-funds in the first quarter of 2016. The London CIV contacted the council sometime in January 2016, for the launch of two sub funds which the Fund has with Baillie Gifford to their platform. The transition of Baillie Gifford (DGF) which was £54m was completed 15<sup>th</sup> February 2016 and the transition of Baillie Gifford Global Alpha fund of some £205m has been postponed to sometime in March 2016 to allow the Irish tax office to make a decision of waiving stamp duty on the transition.

#### **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

- 4.1 The comments of the Corporate Director of Resources are incorporated in the report. Any appropriate management fee costs relating to LBTH would be borne by the pension fund.

#### **5. LEGAL COMMENTS**

- 5.1 The government has issued detailed Criteria and Guidance on investment reform and pooling of local government pension funds to which the Council has responded as required. To enable Members to fulfil their statutory duties in respect of the proper management of the Council's pension fund, it is appropriate that they are kept informed of developments relating to the pooling of investment funds and collaboration with other pension fund schemes.
- 5.2 The Pension Committee has previously decided to manage the investment fund through the London CIV. However, this is only for the purposes of the Pension Committees duties and does not affect the application of the prevailing law relating to procurement.
- 5.3 For the purposes of performing activities in respect of the Pension Committee the Pension Committee has delegated the ability to act to the Council. Therefore, when determining whether or not to take advantage of purchased services the Pension Committee does so through the Council. It is the Council that is the purchaser.

- 5.4 Therefore, for the purposes of determining how the Pension Committee should join the LGPS framework procurement the same rules apply as if the beneficiary of the services were the Council itself.
- 5.5 The Council is a “Contracting Authority” for the purposes of the Public Contracts Regulations 2015 which enshrines the prevailing Procurement Law for the purposes of this report. As a contracting authority the Council and therefore, the Pension Committee must subject purchases to competitive exercises to the standard required by the Regulations.
- 5.6 However, in the circumstances outlined in the report it will not be the Council who is undertaking the procurement but a central government led purchasing body. Therefore, there must be adherence to certain rules to ensure that the Council and therefore the Pension Committee’s procurement obligations have been met.
- 5.7 It must also be considered feasible that the Pension Committee may benefit from services acquired under the framework where the London CIV itself purchases services. Again, the CIV would be considered to be a Contracting Authority for the purposes of the Regulations and certain rules must be followed to ensure that the CIV’s activities satisfy the Council’s duty to subject purchases to competition.
- 5.8 Therefore, in any advert for the competitive exercise for the formation of any framework from which the Pension Committee may obtain a benefit it must be clear that:
- 5.8.1 The London Borough Of Tower Hamlets and the Pension Committee for which it acts intends to use the procured frameworks and
- 5.8.2 The London Borough Of Tower Hamlets and the Pension Committee for which it acts may use the frameworks indirectly through the London CIV and
- 5.8.3 The London CIV may procure services through the procured frameworks.
- 5.9 The essence of the law in this area is to ensure that bidders have a significant amount of certainty as to who may use the procured framework and therefore, have certainty as to the potential value of services that may be available if they win the framework competition.
- 5.10 To give certainty potential purchasers from the framework must be “immediately identifiable” from the description of purchasers used in the advert. Therefore, it would be advisable to specifically state the above rather than use general catch all phrases such as “all London Boroughs” or such other wording.
- 5.11 The Council also has a duty to ensure that any purchases it makes represent Best Value for the purposes of Section 3 Local Government Act 1999. It is

likely that the framework will include a number of suppliers and the Council will still have to show Best Value.

- 5.12 It would be usual, therefore, to include for some further competitive exercise (like a mini-tender) once the specific requirements are understood for the purchase of the services each time.
- 5.13 However, it should be noted that in any event a purchase from a single provider under a framework is only allowable (notwithstanding the rules set down in the framework itself) where the Council can show that the particular supplier presented the best value bid during the competitive exercise under which the framework was originally created. Otherwise, there can be no demonstration of Best Value.
- 5.14 Once the frameworks have been created subsequent purchases from the frameworks should be still subject to the approvals requirements set down in the Council's Constitution.
- 5.15 When deciding whether or not to proceed with a project, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty).

## **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.
- 6.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

## **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 To have an efficient, cost reduction platform for investment management of the fund by pooling and collaborating is considered to be a good decision which can result in greater cost savings to the fund.

## **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 The rigorous robust management of LBTH Pension Fund results in better quicker and more effective decision making which can lead to better Fund performance and reduction in the contribution required from the Council towards the Fund. The monitoring arrangement for the Pension Fund and the work of the Pensions Committee should ensure that the Fund optimises the

use of its resources in achieving the best returns for the Council and members of the Fund.

## **10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 10.1 There are no crime and disorder reduction implications arising from this report.
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### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

- NONE

#### **Appendices**

- Appendix 1 – Analysis of boroughs holdings as at 31 March 2015

#### **Local Government Act, 1972 Section 100D (As amended)**

#### **List of “Background Papers” used in the preparation of this report**

- NONE

#### **Officer contact details for documents:**

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## Appendix 1: Analysis of current borough holdings

### Current asset allocation

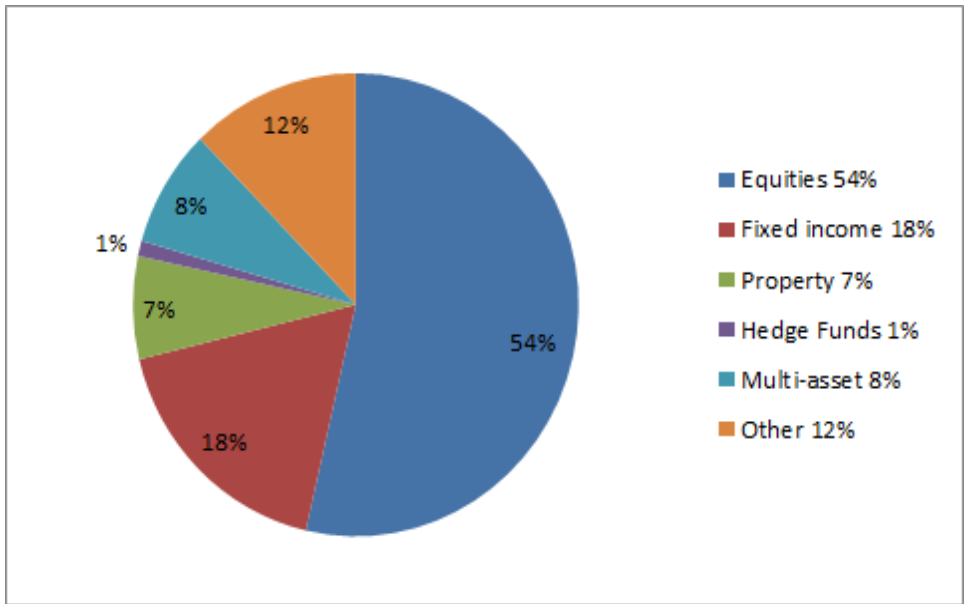
The breakdown of the pension fund assets as of 31 March 2015 for the 31 participating London boroughs can be seen below:

Table 1

<b>Allocation</b>	<b>£m, March 2015</b>	<b>Percentage</b>
UK equities	5,077.39	18.9%
overseas equities	6,560.63	24.4%
unallocated	2,748.31	10.2%
<b>total equities</b>	<b>14,386.33</b>	<b>53.6%</b>
UK fixed interest	2,636.29	9.8%
overseas fixed interest	808.32	3.0%
unallocated	863.04	3.2%
<b>total fixed interest</b>	<b>4,307.65</b>	<b>16.0%</b>
UK index linked	312.52	1.2%
overseas index linked	30.01	0.1%
unallocated	80.43	0.3%
<b>total index linked</b>	<b>422.96</b>	<b>1.6%</b>
UK property	1,350.87	5.0%
overseas property	56.85	0.2%
unallocated	517.01	1.9%
<b>total property</b>	<b>1,924.73</b>	<b>7.2%</b>
UK hedge funds	32.40	0.1%
overseas hedge funds	-	0.0%
unallocated	256.56	1.0%
<b>total hedge funds</b>	<b>288.96</b>	<b>1.1%</b>
UK other	783.74	2.9%
overseas other	963.62	3.6%
<b>Multi-asset</b>	<b>2,214.31</b>	<b>8.2%</b>
<b>Total unallocated</b>	<b>3,961.67</b>	<b>14.8%</b>
infrastructure	193.53	0.7%
commodities	57.43	0.2%
private equity	525.05	2.0%
derivatives	- 2.28	0.0%
currency overlay	-	0.0%
cash	777.37	2.9%
<b>Total investment assets</b>	<b>26,843.38</b>	<b>100.0%</b>

NB the multi-asset allocation is done on a "best efforts basis" due to conflicting and out of date data.





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