

3 February 2014

Kimberley Linge
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Dear Kimberley

Scheme Governance Discussion Paper

Further to the scheme governance discussion paper issued on 23 December 2013, in which you sought comments regarding how the Scottish government might incorporate the governance provisions of the Public Service Pensions Act 2013 in the governance arrangements for the Local Government Pension Scheme.

CIPFA, via its Pensions Panel, has long had an interest in the governance arrangements in the LGPS and has over the years provided guidance to LGPS practitioners on various aspects of the governance framework, including knowledge and skills, risk management and investment decision-making. Consequently we have a strong professional interest in how the requirements of the Public Service Pensions Act 2013 will impact upon LGPS governance.

Our overall conclusion is that wherever possible, the regulations should avoid over-prescription and should aim to allow funds the maximum possible flexibility to implement the requirements of the Public Service Pensions Act in such a way that suits their own local circumstances. This would follow the well-established and successful model for pension fund decision-making bodies in the LGPS, where individual funds can structure their governance arrangements according to local determinants.

As requested in the consultation document we have provided comments in response to the specific questions posed in your letter in the attached Annex.

I hope these comments are a useful contribution to your consideration of the implications for the LGPS of the governance requirements of the Public Service Pensions Act 2013. If you would like to discuss further any of the points raised, please do not hesitate to contact me at nigel.keogh@cipfa.org.

Yours sincerely

Nigel Keogh
CIPFA Pensions Technical Manager



INVESTOR IN PEOPLE

Annex A

Part 1 - "Scheme manager"

1.1 Section 4 of the Act requires the new Scheme regulations to provide for a person ("the scheme manager") to be responsible for managing or administering the Scheme. The term "person" is not to be taken literally. In the Local Government Pension Scheme (Scotland), the "scheme manager" for the purposes of Section 4 will be each of the individual Scheme administering authorities in Scotland.

Part 2 - "Pension board"

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

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

1.3 In making these regulations, Scottish Ministers as the "responsible authority", must have regard to the desirability of securing the effective and efficient governance and administration of the Scheme and any connected schemes.

1.4 Regulations will also need to include provision requiring each scheme manager to be satisfied that a person to be appointed as a member of a pension board does not have a conflict of interest, either at the outset, or from time to time. Section 5(5) of the Act defines "conflict of interest" as any financial or other interest which is likely to prejudice the person's exercise of functions as a member of the board, but does not include a financial or other interest arising merely by virtue of being a member of the Scheme.

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

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

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

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

Implementation

1.9 It is clear that the new Scheme regulations will need to require each scheme manager/administering authority to establish their own pension board.

1.10 To comply with Section 5 of the Act, the new Scheme regulations will need to include the role of each pension board to assist the scheme manager/administering authority in securing compliance with scheme regulations and other legislation; with the Pension Regulator's codes of practice and with any other matters specified in Scheme regulations.

Q1. What "other matters", if any, should we include in Scheme regulations to add to the role of local pension boards?

Comments:

In considering whether any "other matters" should be set out specifically in Scheme regulations with regard to the role of the pensions board, it should be borne in mind that the Public Service Pensions Act requirements are in many areas drafted with the central government/unfunded schemes clearly in mind and this is one example.

In those schemes there is little in the way of pre-existing statutory governance or reporting requirements (beyond annual accounting requirements). There is therefore a case for the pensions board to have the flexibility to look at matters outside the confines of Regulations 5(2a) and 5(2b), although these in themselves are fairly broadly drawn.

The same lack of statutory scrutiny cannot be said of the LGPS where there are existing requirements for reporting on governance compliance, pensions administration, funding strategy, investment principles, communications strategy etc.

Given the nexus of governance in the LGPS which comprises pensions committees, SPPA, the Scheme Advisory Board, professional codes of practice and, from 2015, Pensions Regulator, we are not minded to suggest any extension to the role of pensions boards at this time. However Ministers may wish to include in the scheme regulations powers for it to add to the role of the pensions board should any gaps in the scrutiny framework become apparent that the pensions board may be in a position to fill.

1.11 There is a requirement for scheme managers/administering authorities to check that no person appointed to the board has any conflict of interest as defined in the Act and also to undertake regular checks;

Q2. Should Scheme regulations make it clear that nobody with a conflict of interest, as defined, may be appointed to or sit on a pension board?

Comments:

The Public Service Pensions Act already requires that the scheme manager (in the case of the LGPS, the administering authority) take steps to manage conflicts of interest in respect of persons appointed to a pension board.

We see no particular difficulty in the scheme regulations reiterating this requirement. However this should be supported by guidance to administering authorities on identifying and managing conflicts of interest which expands upon that given in the Public Service Pensions Act at Regulation 5(5). For example section 151 officers have a key role to play in both the management of the fund and the management of the administering authority's finances, and in view of this and other pressures, the CIPFA Pensions Panel is already committed to issuing guidance on managing conflicts of interest in the LGPS.

1.12 There is a provision requiring a member of the board or person proposed to be a board member to provide whatever information about conflict of interest that the scheme manager/administering authority reasonably require.

Q3. Should Scheme regulations prescribe the type of information that may be "reasonably required"?

Comments:

Prescribing the information required in regulation may prove unwieldy. DCLG will need to strike a balance between the defined information requirements that are:

- not too limiting to the steps that the administering authority feels are necessary to fulfil their duties under the Public Service Pensions Act, and;
- information requirements that are over-burdensome on both prospective pension board member and administering authority.

Consequently we feel that this is an area that is best left to the discretion of the administering authority supported by the guidance mentioned.

Q4. Should Scheme regulations prescribe the requirement for managers/administering authorities to undertake regular checks to ensure board members do not have any conflicts of interest?

Comments:

Please see response to Question 2.

1.13 There is a requirement that each pension board must include employer representatives and member representatives in equal numbers.

Q5. Although not required by the Act, should Scheme regulations prescribe a minimum number of employer and employee representatives?

Comments:

The Public Service Pensions Act does not set a minimum level of employer and employee representatives and we believe that Ministers should avoid prescribing a minimum in scheme regulations. As a general principle, the CIPFA believes that wherever possible the Scheme regulations regarding pensions boards should avoid too great a level of prescription and that administering authorities should have the maximum possible flexibility to implement the requirements of the Public Service Pensions Act in such a way that suits their own local circumstances.

Clearly in order to accommodate the different member and employer constituencies, more than one representative on each side will be required. However funds should be free to determine their own membership levels based upon local circumstances. To impose a minimum number may place an unnecessary burden on funds where employer/employee participation is limited or difficult to secure. It may also artificially inflate the training requirements and associated costs imposed upon an authority where a minimum number of members is set above that that the authority deems that it requires to discharge the role of the pensions board.

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

1.15 The argument for and against separate bodies is finely balanced. Those who support the committee and pension board being one and the same body argue that local government cannot afford to spend more time and money setting up new bodies, particularly when the function could easily be undertaken by existing pension or investment committees. Others argue that a statutory decision making committee is in

no position to fulfil the clear scrutiny role set out in the Act. It cannot, in effect, scrutinise itself and be in a position to assure the scheme manager that it is complying with all relevant legislation and Pension Regulator's codes of practice.

1.16 Whilst we are seeking your views on the status of local pension boards and statutory committees, it is likely that Scheme Regulations will require that the final outcome must be applied consistently across the Scheme as a whole, i.e. all pension boards will either be combined or separated from statutory committees.

Q6. How should the governance of the local government pension scheme in Scotland change to incorporate the changes required by the Act?

Q7. Should the new Scheme regulations require local pension boards to be a body separate from the statutory committee or for it to be combined as a single body?

It would be helpful if you could provide the reasons which support your answer.

Comments:

The Public Service Pensions Act permits scheme regulations to be drafted in such a way as to allow the pensions committee to take on the role of the pensions board. However principles of good governance would suggest that the roles of decision-making and scrutiny should be formally separated. The regulations should therefore require such separation.

Notwithstanding the desire for a consistent approach to be adopted across Scottish funds, as we have previously stated above, this is an area where we feel the detailed arrangements for discharging the responsibilities of the pensions board as set out in the Public Service Pensions Act would be most effectively be determined at local level. Many funds have existing scrutiny arrangements and should have the latitude to amend these to meet the requirements of the Public Service Pensions Act.

Membership of Pensions Boards

1.17 Apart from requiring equal numbers of employer and scheme member representatives and the restriction on conflicts of interest, the Act is silent on key issues of the pension board including, for example, membership, constitution, frequency of meetings, the nomination process and training.

Q8. To what extent should the new Scheme regulations specify the types of members of the pension boards?

Q9. How should the Pension Boards be chaired?

Q10. What should happen in the event of a tied vote at a Pensions Board?

Q11. To what extent should the new Scheme regulations specify the manner in which members of the pensions boards are selected?

Comments:

As noted in our opening comments, our view is that wherever possible, the regulations should avoid over-prescription and should aim to allow funds the maximum possible flexibility to implement the requirements of the Public Service Pensions Act in such a way that suits their own local circumstances. This would follow the well-established and successful model for pension fund decision-making bodies in the LGPS, where individual funds can structure their governance arrangements according to local determinants.

1.19 Guidance currently sets best practice for funds to include representatives of participating employers, admitted bodies and scheme members (including pensioner and deferred members) in their governance. However the pension board will compel member and employer representation.

Q12. Should the introduction of the pension board affect employer and member representation in other parts of funds' governance? If yes, how?

Comments:

There is no particular reason why the creation of the Pension Board should affect employer/employee representation elsewhere in the fund governance structure. However we believe that any restriction on how funds manage the process of setting up their local pensions board, including how employer and employee representatives are selected, would limit the ability of funds to implement the requirements of the Public Service Pensions Act.

As noted in our response to Question 5, such restrictions may place an unnecessary burden on funds where employer/employee participation is limited or difficult to secure. It may also artificially inflate the training requirements and associated costs imposed upon an authority.

Accountability of the Board

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

Q13. Should the new Scheme regulations include a requirement for each local pension board to publish an annual statement of its work and for this to be sent to the relevant scheme manager, all scheme employers, the scheme advisory board and Pensions Regulator?

Comments:

The CIPFA Pensions Panel would support the inclusion of such a requirement, supported by appropriate statutory guidance.

Training and qualifications

1.21 Paragraph 14 of Schedule 4 of the Act amends Section 90 of The Pensions Act 2004 and requires the Pensions Regulator to issue various codes of practice, including one on the requirements for knowledge and understanding of members appointed to pension boards of public service pension schemes.

1.22 Scottish Ministers, together with other interested parties, are being consulted on the content of this and other codes of practice and this ought to be sufficient to ensure that the specific circumstances of the Local Government Pension Scheme in Scotland and the role of new local pension boards can be taken into account.

Q14. Apart from the training and qualification criteria that may be covered by the Pensions Regulator in a code of practice, are there any specific issues that we should aim to cover in the new Scheme regulations as well?

Comments:

Beyond the existing CIPFA Code of Practice on Knowledge and Skills and whatever knowledge and skills requirements the Pensions Regulator may introduce in respect of pensions boards members, we do not believe that there are any further criteria that need be set down in regulation.

Part 3 – “Scheme advisory board”

1.23 Section 7(1) of the Act will require Scheme regulations to provide for the establishment of a board with responsibility for providing advice to Scottish Ministers, at their request, on the desirability of changes to the Scheme.

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

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

Membership

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

- The Scottish Local Government Pensions Advisory Group (SLOGPAG), could consider and make recommendations to Scottish Ministers relating to the number of members, where those members should be drawn from and the balance of membership across the representative areas e.g. employer and employee representatives;
- Scottish Ministers could appoint a small membership panel whose remit would be to nominate and appoint initial members of the board, including the Chairperson;
- The membership profile of SLOGPAG could be carried forward.

Implementation

Scope/role

1.27 Section 7(1) of the Act defines the scope and role of the scheme advisory board in the widest possible terms (see paragraph 1.23 above). Replicating the wording of the Act in Scheme regulations would be advantageous in terms of allowing the work of the scheme advisory board to evolve without the need for regulatory amendments, but equally, there may be merit in clearly defining certain areas of work, for example, making recommendations to Scottish Ministers on cost management proposals.

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

Comments:

We would agree that the wording in the Public Service Pensions Act is sufficiently broad as to allow the Scheme Advisory Board to develop its own remit and allow this to evolve over time. Seeking to more tightly define the role of the Board in scheme regulations may in the medium to long term prove limiting and would require regulatory intervention to keep aligned with the evolving role of the Board.

1.28 Section 7(1) of the Act provides that the scheme advisory board is responsible for providing advice to Scottish Ministers, as the responsible authority, at their request. It has been suggested that Scheme regulations include a requirement the advisory board to advise Scottish Ministers on the desirability of changes to the Scheme.

Q16. Should Scheme regulations include a general provision enabling the scheme advisory board to advise Scottish Ministers on the desirability of changes to the Scheme as and when deemed necessary?

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

Comments:

We believe that it is a primary responsibility of the Scheme Advisory Board to advise the Secretary of State on matters that it deems necessary. This may be on the need for scheme changes but also on matters where the Board feels the Secretary of State should intervene. Consequently our preference would be that scheme regulations do not seek to limit those areas upon which, or instances when, the Board should provide such advice.

Q18. What would be your preference be for establishing membership of the scheme advisory board?

Comments:

CIPFA has no particular preference with regards to the method for establishing the Board. However whatever means is chosen, it should ensure that all relevant stakeholders are represented and that the Board has access to the necessary advice and expertise require to fulfil its remit.

Q19. Should Scheme regulations require the Scottish Ministers to approve any recommendation made for the position of Chair?

Q20. Should Scheme regulations prescribe tenure of office? If so, what should the maximum period of office be and should this also apply to the Chair of the board?

Comments:

The selection of the Chair will be critical in ensuring that the Board enjoys the confidence and respect of all scheme stakeholders and Secretary of State approval of the chair will help to imbue the role with the necessary status. We would therefore support scheme regulations requiring Secretary of State approval and powers to remove (in prescribed circumstances – see Question 21). The regulations should also stipulate length of tenure. As certain elements of the work of the Board will be driven by the outcome of fund triennial valuations, we would suggest a minimum three year term. However DCLG might wish to consider tying the length of tenure in with the electoral cycle which would suggest a slightly longer period. For Board members we suggest that this be reserved for the Board to determine within its own terms of reference.

Q21. Should Scheme regulations make provision for board members, including the Chair, to be removed in prescribed circumstances, for example, for failing to attend a minimum number of meetings per annum? If so, who should be responsible for removing members and in what circumstances (other than where a conflict of interest has arisen) should removal be sought?

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

Q23. Should Scheme regulations prescribe the number of attendees for the board to be quorate? If so, how many or what percentage of the board's membership should be required to be in attendance?

Q24. Rather than make specific provision in Scheme regulations, should the matters discussed at Q16 to Q23 be left as matters for the scheme advisory board itself to consider and determine?

Comments:

We believe that the matters of procedural detail set out in Questions 21 to 23 should be left for the Board to consider and determine.

Shadow Advisory Board

1.29 The Scheme Advisory Board will be established from 1 April 2015 and the establishment of a Shadow Scheme Advisory Board will be kept under review, but such a Shadow Scheme Advisory Board is anticipated to be beneficial from Autumn 2014 onwards.

1.30 In the period until the Board (or Shadow Board) is established, SLOGPAG will review the governance arrangements within its agreed remit of developing a new Scottish LGPS. Topics for consideration will include, but are not limited to:

- a. The structure of the 4 governance related roles identified by the Public Service Pensions Act 2013
- b. The membership and constitution of the Scheme Advisory Board
- c. Operation of the cost control mechanism
- d. The requirements of the Pensions Regulator
- e. Publication of scheme information
- f. Relevant provisions in the Institutions of Occupational Retirement Provision (IORP)
- g. Data collection

Q25. What other specific issues should SLOGPAG consider prior to the Board being established?

Q26. Under what circumstances should a Shadow Board be established prior to April 2015?

Comments:

One clear advantage to establishing the Board in shadow form, is that it allows time for matters such as constitution, seeking a chair and members, establishing terms of reference and organising a forward work plan to be addressed before going fully live. Experience in England and Wales has shown that these administrative issues can take time to resolve.

Resourcing of the Advisory Board

1.31 If the scheme advisory board is to undertake its full range of duties effectively, it will need to have access to finance for example to pay for secretarial services and the necessary advice or analysis on which to base its decisions.

1.32 It is proposed this is regarded as an administration cost and therefore payable by the individual pension funds.

Q27. Do you agree that the scheme advisory board should be funded by a mandatory levy on all Scheme pension fund authorities? If not, what alternative approach would you propose?

Comments:

A major risk associated with associated with a voluntary subscription is that the board's agenda and workplans would be subject to an uncertain level of funding, dependent on whether or not individual fund authorities considered the work of the board to represent good value for money. A further risk with a voluntary regime is that funds may regard participation in the Board's work and compliance with its recommendations equally voluntary.

The mandatory levy would not only give the board the financial certainty that it would need to be able to discharge its functions but also reinforce its legitimacy to act across all LGPS funds.

Q28. How should the subscription vary by fund? Should it be a fixed fee for all funds or proportional to their membership?

Comments:

A fee proportional to membership size would seem to be an equitable solution and is already accepted practice in relation to subscription based services.

Constitution

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

Q29. What would be your preferred manner of legal constitution of the scheme advisory board and how should Scheme regulations deal with the issue of personal liability protection for board members?

Comments:

CIPFA has no particular preference regarding the legal constitution of the Board but is clear that there should be no personal liability issues for its members on the grounds that they are volunteers and are not undertaking the role in a commercial capacity.

General

1.35 The current LGPS (Scotland) Regulations have a 'light touch' on governance, instead they refer to the Governance Compliance Statement. This allows for changes in governance arrangements to be made without having to amend existing regulations.

Q31. Would it be preferable to retain a 'light touch' to governance in the Scheme regulations, with reference instead to a Governance Compliance Document which would contain the detailed governance requirements?

Comments:

As noted in our opening comments, our overall conclusion is that wherever possible, the regulations should avoid over-prescription and should aim to allow funds the maximum possible flexibility to implement the requirements of the Public Service Pensions Act in such a way that suits their own local circumstances. This would follow the well-established and successful model for pension fund decision-making bodies in the LGPS, where individual funds can structure their governance arrangements according to local determinants.

**CONSULTATION RESPONSE FORM
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(please complete and return to the address at the end of the form to ensure that we handle your response appropriately).

1. Name/Organisation

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3. Permissions - I am responding as... (please complete either sections (a), (b) and (d) **or** sections (c) and (d)):

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(a) Do you agree to your response being made available to the public (in Scottish Government library and/or on the Scottish Government web site)?

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(c) The name and address of your organisation **will be** made available to the public (in the Scottish Government library and/or on the Scottish Government web site). Are you content for your **response** to be made available?

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(d) We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Please state yes or no: YES

