

# **Lancashire County Council**

## **Pension Fund Committee**

**Friday, 28th November, 2014 at 10.45 am in Cabinet Room 'C' - County Hall,  
Preston**

### **Agenda**

#### **Part 1 (Open to Press and Public)**

<b>No.</b>	<b>Item</b>
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<b>1.</b>	<b>Apologies</b>
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<b>2.</b>	<b>Disclosure of Pecuniary and Non-Pecuniary Interests</b>
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Members are asked to consider any Pecuniary and Non-Pecuniary Interests they may have to disclose to the meeting in relation to matters under consideration on the Agenda.

<b>3.</b>	<b>Minutes of the Meeting held on 5 September 2014</b>	<b>(Pages 1 - 6)</b>
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To be confirmed, and signed by the chair.

<b>4.</b>	<b>Exclusion of Press and Public</b>
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The Committee is asked to consider whether, under Section 100A(4) of the Local Government Act, 1972, it considers that the public should be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the appropriate paragraph of Part 1 of Schedule 12A to the Local Government Act, 1972, as indicated against the heading to the item.

#### **Part II (Not open to Press and Public)**

<b>5.</b>	<b>Investment Performance Report</b>	<b>(Pages 7 - 26)</b>
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(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

**6. Investment Panel Report** (Pages 27 - 40)

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

**7. Property Management Procurement** (Pages 41 - 56)

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

**8. Collaboration with other Funds**

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

Report to follow

**Part I (Open to Press and Public)**

**9. Transaction of Urgent Business - Response to Government Consultations** (Pages 57 - 154)

**10. Establishment of the Lancashire Pension Board** (Pages 155 - 172)

**11. Impact of County Council Transformation Programme on the arrangements for managing the Lancashire County Pension Fund** (Pages 173 - 176)

**12. Report of the Appointments Sub-Committee** (Pages 177 - 182)

**13. Shareholder Voting and Engagement Report** (Pages 183 - 262)

**14. UK Stewardship Code compliance** (Pages 263 - 282)

**15. Report of the Socially Responsible Investment Working Group** (Pages 283 - 296)

**16. Interim Administration Report** (Pages 297 - 306)

**17. Feedback on External Pension Fund Training Events Attended by Members** (Pages 307 - 316)

**18. External Audit Findings Report - Lancashire Pension Fund - 2013/14** (Pages 317 - 342)

**19. Urgent Business**

An item of urgent business may only be considered under this heading where, by reason of special circumstances to be recorded in the Minutes, the Chair of the meeting is of the opinion that the item should be considered at the meeting as a matter of urgency. Wherever possible, the Chief Executive should be given advance warning of any Member's intention to raise a matter under this heading.

**20. Date of Next Meeting**

The next meeting of the Committee will be held on Friday 27 March 2015 at 10.00 a.m. at County Hall, Preston.

I Young  
County Secretary and Solicitor

County Hall  
Preston



# Agenda Item 3

## Lancashire County Council

### Pension Fund Committee

**Minutes of the Meeting held on Friday, 5th September, 2014 at 9.30 am in Cabinet Room 'C' - County Hall, Preston**

#### **Present:**

County Councillor Terry Burns (Chair)

#### **County Councillors**

L Beavers	M Parkinson
D Borrow	A Schofield
M Brindle	K Sedgewick
G Dowding	R Newman-Thompson
J Oakes	D Westley
M Otter	B Yates

#### **Co-opted members**

Paul Crewe, (Trade Union representative)  
Bob Harvey, (Trade Union representative)  
Jane McCann, (HE/FE sector establishments representative)  
Councillor Edward Pope, (Lancashire Leaders' Group representative)  
Councillor Mark Smith, (Blackpool Council representative)  
Councillor Ron Whittle, (Blackburn with Darwen Borough Council representative)

County Councillor R Newman-Thompson replaced County Councillor J Gibson at this meeting.

Eric Lambert and Noel Mills, Independent Advisers to the Pension Fund were also present.

It was reported that Paul Crewe had been appointed to represent the Trade Unions on the Committee. It was also reported that Councillor Edward Pope had been appointed to represent the Lancashire Leaders' Group.

#### **1. Apologies**

Apologies were received from Councillor P Leadbetter.

## **2. Disclosure of Pecuniary and Non-Pecuniary Interests**

None.

## **3. Minutes of the Meeting held on 6 June 2014**

The Minutes of the meeting held on 6 June 2014 were presented.

**Resolved:** That the Minutes of the meeting held on 6 June 2014 be confirmed and signed by the chair.

## **4. Exclusion of Press and Public**

**Resolved:** That the press and members of the public be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the paragraph of Part 1 of schedule 12A to the Local Government Act, 1972, indicated against the heading to the item. It was considered that in all the circumstances the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

## **5. Investment Performance Report**

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee considered a report on the performance of the Fund as at 30 June 2014, focussing on the key areas of:

- the funding position;
- cash flow;
- fund investment performance;
- management performance;
- investment allocations; and
- risk management of the Fund including liability, credit, liquidity, investment and operational risks.

**Resolved:** That the report be noted.

## **6. Investment Panel Report**

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee received a report from the Investment Panel setting out the work of the Panel at its meetings held on 6 June and 21 July 2014. The Committee's attention was specifically drawn to the following key areas:

- The Investment Context in which the Fund was operating;
- Updates on property activity;
- Asset Trust Investment Format;
- Ground rent proposal; and
- Liability Risk Management

**Resolved:** That the report be noted.

The Committee then returned to the remaining Part I agenda items.

## **7. Annual Report and Statement of Accounts of Lancashire County Pension Fund for the year ended 31 March 2014**

The Committee considered the Annual Report and Accounts of the Pension Fund for 2013/14.

It was noted that the Statement of Accounts was currently being audited by the external auditor and the auditor's opinion, together with any changes required as a result of the audit process would be included in the published Annual Report, when this had been completed.

A copy of the Annual Report 2013/14 was presented at Appendix 'A'. The content of the Annual Report included the following sections:

- An overview of the management and financial performance of the fund;
- The Governance Compliance Statement;
- Administration of the Fund;
- Knowledge and Skills Framework
- Investments of the Fund;
- The accounts and financial statements;
- Actuarial Valuation;
- The Governance Policy Statement;
- The Communication Policy Statement;
- The Funding Strategy Statement;
- The Statement of Investment Principles

It was noted that the County Council's Constitution required the Pension Fund Annual Report to be approved by the Committee and submitted to the Full Council for information.

**Resolved:** That the 2013/14 Lancashire County Pension Fund Annual Report, as now presented, be approved for submission to the Full Council.

## **8. Shareholder Voting and Engagement Report**

The Committee considered a comprehensive report on the Fund's shareholder voting arrangements and activity, and engagement activity for the period 1 April to 30 June 2014. The report also set out details of potential class actions in relation to companies in which the Lancashire County Pension fund currently owned shares or had previously owned shares.

It was noted that PIRC were collating UK proxy voting outcomes for the 2014 voting 'season' and would provide a report following the end of the September quarter. This would enable PIRC to review voting recommendations provided on behalf of Fund, as well as reviewing market trends and the significance of developments affecting those outcomes.

The expected report would also provide a commentary on the proxy season from the viewpoint of how institutional investors voting outcomes had impacted on individual company results, as well as the impact of highlighting new issues and the broader support for governance changes that investors had been arguing for. In addition, it would have a full statistical analysis of the Fund's voting record. This information would be included in future reports to the Committee.

**Resolved:** That the report be noted.

## **9. Lancashire County Pension Fund Risk Register**

The Committee considered the Fund's Risk Register six monthly update report.

It was noted that the Risk Register had been reviewed by risk owners and that two new risks had been identified. The Committee's attention was also drawn to the areas currently designated as 'high' risk.

**Resolved:** That the report be noted.

## **10. Opportunities for Co-operation with Other Funds Within the Local Government Pension Scheme**

The Committee considered a report on possible opportunities for collaborative working with other Local Government Pension Schemes.

It was noted that the Committee had in its various responses to Government consultation documents supported the proposition that increased collaboration between funds would be beneficial. The Committee was informed that a range of opportunities for collaboration were presenting themselves and an approach to dealing with the opportunities including potential areas for discussion was presented.

**Resolved:**



That officers be authorised to engage in exploratory discussions with other Local Government Pension Schemes on possible opportunities for co-operative working.

## **11. Extension of Contract for Actuarial Services**

The Committee considered a report on the contract arrangements for the provision of actuarial services to the Fund.

It was noted that the current three year contract with the Fund's Actuary, Mercers, was due to expire and that it was proposed to take up the option to extend the contract for a further three years to September 2017. This would enable the Fund to continue to work with the Actuary beyond the completion of the next schedule actuarial valuation (31 March 2016) thus providing continuity and consistency of service. A procurement process would be undertaken following the expiry of the contract in September 2017.

**Resolved:** That the proposed extension of the current contract for the provision of actuarial services to the Fund to September 2017 be noted.

## **12. Transaction of Urgent Business**

The Committee's responses to the following Government consultation exercises were presented:

- Opportunities for Collaboration, Cost Savings and Efficiencies within the Local Government Pension Scheme;
- Draft scheme governance regulations for the Local Government Pension Scheme

It was noted that the responses had been approved under the County Council's Urgent Business Procedure as the closing dates for submissions were prior to the next scheduled meeting of the Committee.

The Committee welcomed the responses and fully endorsed the views and concerns which had been expressed to Government. Members were particularly concerned about increased risks caused by:

- reduced accountability, control and oversight to deliver an effective strategy to eliminate the Fund's deficit;
- the Government's focus on fee reduction measures;
- the pooling of LGPS assets to a single strategy based around a common investment vehicle;
- the requirement to change asset allocation from active to passive management;
- the Government's one size fits all solution for all public sector pension schemes, which appeared to ignore the fundamental differences between the LGPS, which already had effective and inclusive governance

- arrangements which could be built on and the unfunded schemes which did not; and
- the potential conflict between the new Pension Board and pre-existing committees, and the exclusion of democratically elected councillors from the Board.

It was suggested that Lancashire Members of Parliament be informed of the Fund's views and concerns about the Government's proposals. The Committee agreed that the MPs should be asked to support the consultation responses and to raise the concerns with Government

The Committee was informed that a report on the proposed establishment and membership of the new Pension Board as from 1 April 2015 would need to be presented to Full Council in December 2014. This would follow consultations with stakeholders and consideration of the proposals by the Committee at its meeting on 28 November.

It was felt that a further briefing session should be held prior to the next meeting of the Committee on the implications of the consultation documents and on the proposals for the establishment of the new Pension Board.

### **Resolved**

1. That the report be noted.
2. That Lancashire Members of Parliament be asked to support the Fund's responses to the Government's consultation documents.
3. That a briefing session on the implications of the Government's consultation documents, and on the proposed arrangements for the establishment of a new Pension Board be held prior to the next meeting of the Committee.

### **13. Urgent Business**

None.

### **14. Date of Next Meeting**

It was noted that the next meeting of the Committee would be held on Friday 28 November 2014 at 10.00 am at County Hall, Preston.

I Young  
County Secretary and Solicitor

County Hall  
Preston

# Agenda Item 5

(NOT FOR PUBLICATION: By virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972. It is considered that all the circumstances of the case the public interest in maintaining the exemption outweighs the public interest in disclosing the information)

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# Agenda Item 6

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# Agenda Item 7

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## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: All
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### **Transaction of Urgent Business**

(Appendices 'A' 'B' 'C' and 'D' refer)

Contact for further information:

Chris Mather, (01772) 533559, Office of the Chief Executive,

[Chris.mather@lancashire.gov.uk](mailto:Chris.mather@lancashire.gov.uk)

### **Executive Summary**

This report sets out the Committee's responses to the Government's consultations on:

- Consultation on the Local Government Pension Scheme (Amendment) (Governance) Regulations 2014  
Better Governance and Improved Accountability in the Local Government Pension Scheme
- Local Government Pension Scheme  
Draft Guidance on the creation and operation of Local Pension Boards in England and Wales

The responses (Appendices 'A' and 'B' refer) were approved under the County Council's Urgent Business Procedure as the Government's closing dates were prior to the next scheduled meeting of the Committee.

### **Recommendation**

The Committee is asked to note the report.

### **Background and Advice**

1. Consultation on the Local Government Pension Scheme (Amendment) (Governance) Regulations 2014  
Better Governance and Improved Accountability in the Local Government Pension Scheme

Responses to the Governments 'Draft scheme governance regulations for the Local Government Pension Scheme' were presented to the Committee at its meeting of 5 September 2014. Members were particularly concerned about increased risks caused by:

- the Government's one size fits all solution for all public sector pension schemes, which appeared to ignore the fundamental differences between the LGPS, which already had effective and inclusive governance arrangements which could be built on and the unfunded schemes which did not; and
- the potential conflict between the new Pension Board and pre-existing committees, and the exclusion of democratically elected councillors from the Board.

A further consultation has followed and responses (Appendices 'A' and 'B' refer) were approved under the County Council's Urgent Business Procedure as the Government's closing dates were prior to the next scheduled meeting of the Committee.

The consultation invites comments to further amendments to the draft regulations, which, after taking into account responses to the previous consultation, now includes the provision to allow elected members to become members of a local pension board. However, the amendment prevents elected members or officers of an administering authority who are responsible for the discharge of any function of the Pension Fund Committee from becoming a member of and authority's local pension board.

This consultation also proposes amendments to establish an employer cost cap mechanism to ensure that the risks associated with pension provision are shared more fairly between employers and scheme members.

In addition to making provision for the employer cost cap, the draft regulations also make provision for greater control over the contribution rates actually paid by employers and scheme members. The government's intention to introduce a cost capping mechanism has been the subject of a number of earlier consultations and therefore the concept is familiar and the intention is generally accepted.

## 2. Local Government Pension Scheme

Draft Guidance on the creation and operation of Local Pension Boards in England and Wales

The LGPS Shadow Scheme Advisory Board has launched a consultation on 'Draft Guidance on the creation and operation of Local Pension Boards' to run in parallel with the above consultation. The draft guidance is intended to assist Administering Authorities in establishing local pension boards by April 2015. In addition, comments and questions are invited with a view to the Shadow Scheme Advisory Board issuing a 'Questions & Answers' style document later this year.

The closing date for responses to the above consultations was 21 November 2014 and attached at Appendices 'A' and 'B' are copies of the Committee's responses which has been approved and submitted under the County Council's Urgent Business Procedure. Copies of the respective consultation documents are attached for information at Appendices 'C' and 'D'.

## Consultations



N/A

**Implications:**

N/A

**Local Government (Access to Information) Act 1985  
List of Background Papers**

Paper	Date	Contact/Directorate/Tel
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N/A

Reason for inclusion in Part II, if appropriate

N/A



# **Consultation on the Local Government Pension Scheme (Amendment) (Governance) Regulations 2014 Better Governance and Improved Accountability in the Local Government Pension Scheme**

## **Response from Lancashire County Pension Fund**

Lancashire County Pension Fund welcomes the opportunity to respond to the Government's consultation on better governance and improved accountability in the Local Government Pension Scheme.

### Local pension boards and the Scheme Advisory Board

The Fund has previously responded to the consultation on scheme governance of 23 June 2014 and our response to that consultation is attached for completeness.

In our previous response we expressed our concerns on the exclusion of councillors from the membership of a local pension board and we therefore welcome the amendments to the new Regulation 107 to allow elected members to become members of a local pension board. We accept as reasonable the qualification in the new Regulation 107(3) which prevents elected members or officers of an administering authority who are responsible for the discharge of any function under the Principal 2013 Regulations from becoming a member of that authority's local pension board.

The Fund further welcomes the comprehensive draft guidance on the creation and operation of local pension boards which is set out within the consultation running parallel to this, as released by the Shadow Scheme Advisory Board.

We have no further comments on the establishment and membership of local pension boards or the establishment and membership of the Scheme Advisory Board.

### Scheme Actuary

We accept the new Regulation 114 and the provision for the Secretary of State to appoint a Scheme Actuary to carry out valuations under Treasury Directions for the calculation and measure of an employer cost cap. However, we dispute the rationale set out within this consultation for the appointment of the Government Actuary's Department to fulfil this role. The need to collect data at a national level may present an issue for any appointed actuary but it should not be the deciding factor for appointment. The Fund suggests that the Secretary of State follows proper procurement procedure in order to have an open and transparent process for appointment to this role.

### Employer cost cap

The employer cost cap has been the subject of a number of past consultations. The Fund is therefore comfortable with this concept and believes that the new Regulation

115 reflects the intention for the introduction a cost capping mechanism to ensure that the costs of the Scheme remain stable over time and that the cost is both sustainable and fair to the taxpayer

#### Scheme Advisory Board – Additional functions

The Fund accepts the additional functions of the Scheme Advisory Board, as set out at the new Regulation 116, to make recommendations to the Secretary of State about the steps to be taken to bring the overall cost of the Scheme back to the target overall cost and the proportions of that cost to be met by Scheme employers and by Scheme members. The Fund agrees the additional functions of this new national board on the basis that the board's overall remit is 'to advise the Secretary of State on the desirability of making changes to the Scheme' and on the basis that the regulatory intention is that membership of this board is equally representative of the interests of Scheme employers and Scheme members.

## **Local Government Pension Scheme Draft Guidance on the creation and operation of Local Pension Boards in England and Wales**

### **Response from Lancashire County Pension Fund**

Lancashire County Pension Fund welcomes the opportunity to respond to the LGPS Shadow Scheme Advisory Board public consultation on draft guidance on the creation and operation of local pensions boards in England and Wales. Our comments and additional questions are as follows: -

The Fund would like thank the Shadow Scheme Advisory Board for the provision of such a comprehensive guidance document covering both regulatory and practical issues to be considered in the creation of operation of a local pension board. The document has already proved useful to the administering authority in terms of creating and determining terms of reference for a local pension board.

However, the Authority feels it would benefit from more clarity around the internal reporting requirements of the local pension board. Section 8 of the guidance suggests a level of flexibility in terms of internal reporting requirements which could give rise to some ambiguity in terms of expected internal reporting requirements. The Fund would be grateful for some indication of what the Shadow Scheme Advisory Board would determine to be absolutely necessary in terms of internal reporting requirements.





Department for  
Communities and  
Local Government

# The Local Government Pension Scheme (Amendment) (Governance) Regulations 2014

## Better Governance and Improved Accountability in the Local Government Pension Scheme

Consultation

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# The Consultation Process and How to Respond

## Scope of the consultation

<p><b>Topic of this consultation:</b></p>	<p>The Local Government Pension Scheme (Amendment) (Governance) Regulations 2014.</p> <ol style="list-style-type: none"> <li>1. The intention of these draft regulations is to ensure that the Local Government Pension Scheme in England and Wales is managed well at both national and local levels. They also set out proposals for how the future costs of the scheme to employers and taxpayers will be controlled. Similar arrangements are being introduced for all major public service pension schemes.</li> <li>2. A national scheme advisory board would advise the Department on changes to the scheme's regulations, for example to reflect changes in costs. In addition, each of the 89 administering authorities in England and Wales would establish a local pension board to assist them in managing the Scheme at a local level.</li> <li>3. The Department would need to ensure that any increases or decreases in the cost of the scheme of two percentage points or more would be offset, for example, by varying the rate at which scheme members' benefits build up. This would protect employers and taxpayers against unexpected increases in pension costs.</li> <li>4. In addition, the proposed national scheme advisory board would aim to ensure that the total pension contributions paid by employers and employees were within one percentage point of 19.5% of pensionable pay and that employee contributions were one third of the overall costs. The national board could make recommendations to the Department on changes to the scheme to achieve these targets.</li> <li>5. A more detailed explanation of the arrangements described at paragraphs 3 and 4 above can be found at <a href="https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf">https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf</a></li> </ol>
<p><b>Scope of this consultation:</b></p>	<p>This consultation seeks responses from interested parties on a new Part 3 (Governance) of the Local Government Pension Scheme Regulations 2013 ("the Principal 2013 Regulations") which came into force on 1 April 2014. In addition to the proposed provisions on cost control, the draft regulations at <b>Annex A</b> also includes regulations on Scheme governance that were the subject of a consultation earlier in June at</p>

	<p><a href="https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/322356/consultation_letter_on_June_2014_governance_regulations_final_version-23_june_-with_ISBN.pdf">https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/322356/consultation_letter_on_June_2014_governance_regulations_final_version-23_june_-with_ISBN.pdf</a> .</p> <p>The closing date for comments on those draft regulations was 15 August, but this consultation now provides a second opportunity to comment on those provisions alongside what is now being proposed on cost control. However, it should be noted that in the light of discussions with the shadow scheme advisory board and comments from other scheme interested parties, the draft regulations relating to the local pension boards and the Scheme Advisory Board consulted on earlier have been revised. Comments are therefore invited on the complete set of draft regulations at <b>Annex A</b></p> <p>The comments received in response to the June consultation will be taken into account with those received in response to this consultation.</p>
<b>Geographical scope:</b>	England and Wales.
<b>Impact Assessment:</b>	These Regulations have no impact on business or the voluntary sector.

## Basic Information

<b>To:</b>	<p>The consultation is aimed at all parties with an interest in the Local Government Pension Scheme and in particular those listed on the Government's website:</p> <p><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> .</p>
<b>Body responsible for the consultation:</b>	The Secretary of State for Communities and Local Government is responsible for policy and the consultation exercise.
<b>Duration:</b>	The consultation period will be 6 weeks ending on 21 November 2014. As timing allows, account will be taken of representations made after the close of the consultation.
<b>Compliance with "Principles of Consultation":</b>	This consultation complies with the "Principles of Consultation" . The consultation will be for 6 weeks. This reflects the extensive discussions already held with key interested parties on the development of policy in this area and the extent to which the regulations need to comply with Treasury directions and regulations that have already been subject to consultation.

## Background

<p><b>Getting to this stage:</b></p>	<p>The Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission to review public service pensions and to make recommendations on how they can be made sustainable and affordable in the long term, and fair to both public sector workers and the taxpayer.</p> <p>Since 1996, the cost of the Local Government Pension Scheme to employers and taxpayers has increased from £1.3 billion to £5.9 billion in 2010/11. The proposals in this consultation on scheme governance and cost management are a key element of the Government's reform agenda and will ensure that those who pay the Scheme's costs are fully protected against the rising costs associated with improving longevity. Fairness to the taxpayer is at the heart of the agenda.</p> <p>The recommendations made by Lord Hutton were accepted by the Government and were carried forward into the Public Service Pensions Act 2013 ("the 2013 Act"). A key objective of the 2013 Act is to ensure a fair balance of risks between scheme members and the taxpayer. To achieve this, the Government has established an employer cost cap mechanism to provide backstop protection to the taxpayer and to ensure that the risks associated with pension provision are shared more fairly between employers and scheme members. Details of how the employer cost cap is to be calculated, maintained and the process to be followed when the employer cost cap is breached can be found at <a href="https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf">https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf</a></p> <p>In addition to making provision for the employer cost cap, the regulations also make provision for the agreement reached with the Government by the Local Government Association and local government trade unions to provide greater control over the contribution rates actually paid by employers and scheme members. Details of how this element of the proposed cost control arrangement is intended to work can be found at Chapter 5 of the above pdf document.</p>
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## How to respond

1. You should respond to this consultation by **21 November 2014**.
2. You can respond by email to [Robert.Ellis@communities.gsi.gov.uk](mailto:Robert.Ellis@communities.gsi.gov.uk).  
When responding, please ensure you have the words "LGPS Governance Regulations 2014" in the email subject line.

Alternatively you can write to:

LGPS Governance Regulations 2014  
Department for Communities and Local Government  
Workforce Pay & Pensions  
2<sup>nd</sup> Floor  
South East Quarter  
Fry Building  
2 Marsham Street  
LONDON SW1P 4DF

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

## Additional copies

4. This consultation paper is available on the Department for Communities and Local Government website at: <https://www.gov.uk/government/organisations/department-for-communities-and-local-government>

## Confidentiality and data protection

5. 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, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

6. If you want the information that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act 2000, 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, in itself, be regarded as binding on the department.

7. DCLG will process your personal data in accordance with the Data Protection Act 1998 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.

## Help with queries

8. Questions about any issues raised in the document can be sent to the address given at paragraph 2 above.

9. A copy of the principles on which this consultation is being conducted is at <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>. Are you satisfied that this consultation has followed these principles? If not or you have any other observations about how we can improve the process please email: [consultationcoordinator@communities.gsi.gov.uk](mailto:consultationcoordinator@communities.gsi.gov.uk)

or write to:

DCLG Consultation Co-ordinator, Department for Communities and Local Government,  
Fry Building, 2 Marsham Street, London SW1P 4DF.

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# Chapter 1

## Introduction

- 1.1 This document, in accordance with section 21 of the 2013 Act, commences a period of consultation on the new governance provisions, including cost control arrangements, for the Local Government Pension Scheme. Your comments are invited on the set of draft regulations at **Annex A**.
- 1.2 **The closing date for responses is 21 November 2014.**

## Background and context

- 1.3 This consultation represents another step in the process of reform that began with the Government's commitment to review the efficiency, effectiveness and sustainability of public service pension schemes.
- 1.4 A key aim of the reform process is to ensure a fair balance of risks between scheme members and the taxpayer. To achieve this, section 12 of the 2013 Act requires schemes to set a rate, expressed as a percentage of pensionable earnings of members of the scheme, to be used for the purposes of measuring changes in the cost of the scheme.
- 1.5 The 2013 Act also provides for costs to be measured via regular actuarial valuations and for the establishment of an employer cost cap mechanism to ensure that these costs remain sustainable and fair to taxpayers. Treasury Directions and Regulations specify how valuations are to be carried out and how the employer cost cap mechanism is to operate. In the case of the Local Government Pension Scheme, the employer cost cap will be calculated by a Scheme actuary appointed by the Secretary of State under these regulations based on the 2013 model fund valuation and in accordance with Treasury Directions.
- 1.6 Copies of the relevant Treasury Directions, regulations and accompanying policy paper can be found at <https://www.gov.uk/government/publications/public-service-pensions-actuarial-valuations-and-the-employer-cost-cap-mechanism>.
- 1.7 In addition to the Treasury employer cost cap process, provision is also to be made for the internal cost management process agreed between Government, the Local Government Association and local government trade unions. Unlike the Treasury's employer cost cap process which will monitor changes in the value of benefits in the new Scheme over time, the aim of the internal process is to stabilise the actual contribution rates paid by employers and members in respect of the new Scheme within the overall target cost of 19.5% of pensionable paybill with the target yield from scheme members' contributions being one third of the overall cost.
- 1.8 A detailed explanation of how the internal element of the proposed cost control arrangement is intended to work and the role of the Local Government Pension Scheme Advisory Board in both processes can be found at Chapter 5 of the

document at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/289366/public\\_service\\_pensions\\_actuarial\\_valuations\\_130314.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf)

## **Consultation responses**

1.9 The consultation period is 6 weeks.

1.10. To allow for the fullest response to proposed Scheme regulations, every attempt will be made to include any late submissions.

1.11. Your comments should therefore be sent by 21 November 2014 to Department for Communities and Local Government, Workforce Pay & Pensions, 2<sup>nd</sup> Floor, Fry Building, South East Quarter, 2 Marsham Street, London SW1P 4DF and marked "LGPS Governance Regulations 2014". Electronic responses can be sent to Robert.Ellis@communities.gsi.gov.uk.



# Chapter 2

## Proposals for consultation

- 2.1. The Regulations are being made under the powers conferred by the 2013 Act. Section 3(5) of the 2013 Act requires the consent of Treasury before the Regulations can be made.

### Preliminary Provisions

- 2.2 **Regulation 1** covers the citation, commencement, interpretation and extent of the Regulations. The Regulations will apply to the Scheme in England and Wales and for the most part will come into operation on 1 April 2015.
- 2.3 **Regulations 2 to 8** amend the Principal 2013 Regulations.
- 2.4 **Regulation 8** inserts new regulations 105, 106, 107, 108, 109, 110, 111, 112, 113, 114, 115 and 116 into the Principal 2013 Regulations. These provisions are described in detail immediately below, but in the case of regulations 105 to 113, only to the extent where they differ from the earlier consultation on Scheme governance.

### Main Provisions

- 2.5 **New Regulation 106(6)** has been added to ensure that local pension boards are not unduly restricted in the way they choose to discharge their functions under the regulations.
- 2.6. To reflect concerns expressed by the Shadow Scheme Advisory Board and other scheme interested parties, **Regulation 107** has been amended to allow elected members to become members of a local pension board. However, **Regulation 107(3)** qualifies this provision by not allowing elected members or officers of an administering authority who are responsible for the discharge of any function under the Principal 2013 Regulations (apart from being a member of the Scheme Advisory Board or a local pension board) to become a member of that authority's local pension board.
- 2.7. **Regulation 110(3)** now extends the responsibility of the Scheme Advisory Board to include "connected schemes". Those elements of the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 ("the Transitional Regulations") that concern members who receive entitlement to benefits calculated in accordance with those regulations is regarded as such a connected scheme and this amendment will ensure that the Scheme Advisory Board is able to advise local pension boards on both the Principal 2013 Regulations and the Transitional Regulations
- 2.8. **New Regulation 110(5)** confers the same wider power described at paragraph 2.5 above on the Scheme Advisory Board.

- 2.9. In addition to being responsible for appointing the Chairman of the Scheme Advisory Board, **Regulation 111(1)** has now been amended to make the Secretary of State responsible for appointing members of the Board. Previously, members of the Board were to be appointed by the Chairman and approved by the Secretary of State.
- 2.10. **New Regulation 111(4)** allows the Chairman of the Scheme Advisory Board, with the agreement of the Board, to appoint a maximum of three non-voting advisory members to sit on the Board. **Regulation 111(5)** confers a power for the terms and conditions of such advisory members to be determined.
- 2.11. **Regulation 111(6)** has been amended to the effect that the Chairman's decision to appoint non-Board members as members of any sub-committee is now subject to the agreement of the Board.

### **Scheme actuary (Regulation 114)**

- 2.12 **New Regulation 114** confers power on the Secretary of State to appoint a Scheme actuary to carry out valuations of the Scheme in accordance with Treasury Directions. The Scheme actuary must, in the opinion of the Secretary of State, be appropriately qualified to carry out a valuation of the Scheme. **Regulation 114(4)** requires administering authorities to provide the Scheme actuary with any data that is reasonably required where this is in accordance with directions made by Treasury under section 11 of the 2013 Act.
- 2.13. Having considered the role of the scheme actuary under **Regulations 115** and **116** and, in particular, the need for data collection and analysis at national scheme level, the Department proposes to appoint the Government Actuary's Department as the Scheme actuary under Regulation **114**. Subject to the outcome of the consultation, the appointment would be confirmed in a letter from the Secretary of State to the Government Actuary's Department.

### **Employer cost cap (Regulation 115)**

- 2.14 **New Regulation 115(1)** will set the Scheme's employer cost cap. At this stage, the employer cost cap has not been finalised but during the period of this consultation, a draft valuation report prepared by the Government Actuary's Department in accordance with the Treasury's Public Service Pensions (Valuations and Employer Cost cap) Direction 2014 will be issued to you for information. The draft report will include the proposed employer cost cap figure.
- 2.15. The number of assumptions underlying the calculation of the proposed employer cost cap are set out in the Treasury Direction and cannot be varied. But where appropriate, other scheme specific assumptions must be determined by the Secretary of State after consultation with such persons as he considers appropriate. In this case, consultation on the scheme specific assumptions with the shadow scheme advisory board is considered to be appropriate.
- 2.16. Subject to any comments on the proposed employer cost cap included in the draft valuation report and the views of the shadow board on the scheme specific

assumptions, the final figure will be introduced into **Regulation 115(1)** when the regulations are made.

- 2.17. **Regulation 115(2)** provides that where the cost of the Scheme following a Scheme valuation under Treasury Directions exceeds the margins specified in Treasury regulations, the Secretary of State must follow the procedure set out in **Regulation 115(3)** for reaching agreement on the steps to be taken to bring costs back to the employer cost cap. At present, the margins specified in Treasury regulations are 2% either side of the Scheme's employer cost cap.
- 2.18. **Regulation 115(3)** sets out the procedure for reaching agreement under **Regulation 115(2)**. This requires the Secretary of State to consult the Local Government Pension Scheme Advisory Board on proposals to bring the Scheme's costs back to the employer cost cap and for all members of the Board to reach an agreed position. The period of consultation is at the Secretary of State's discretion.
- 2.19. **Regulation 115(4)** provides that if the agreement required by **Regulation 115(3)** is not reached within 3 months of the end of the consultation period, the Secretary of State must take steps to achieve the target cost by adjusting the rate at which benefits accrue under Regulations 23(4) or (5) of the Principal 2013 Regulations.

### **Scheme advisory board – additional functions (Regulation 116)**

- 2.20. **Regulation 116(1)** requires the Local Government Pension Scheme Advisory Board to obtain a Scheme cost assessment from the Scheme actuary. The assessment must include the overall cost of the Scheme and the proportions of that cost being met by Scheme employers and members as at the date of each actuarial valuation under Regulation 62(1)(a) of the Principal 2013 Regulations.
- 2.21 Except where either **Regulation 115(5) and (6)** applies, **Regulation 116(2)** enables the Local Government Pension Scheme Advisory Board following a Scheme cost assessment, to make recommendations to the Secretary of State to bring the overall cost of the Scheme back to the target overall cost.
- 2.22. **Regulation 116(3)** provides that where the Scheme cost assessment shows that the proportion of the overall cost of the Scheme is above or below the target proportion defined at **Regulation 116(7)**, the Local Government Pension Scheme Advisory Board may make recommendations to the Secretary of State to bring that proportion back to the target proportion.
- 2.23. Prior to any Scheme cost assessment, **Regulation 116(4)** requires the Local Government Pension Scheme Advisory Board to publish its policy on the recommendations it may make to the Secretary of State under **Regulation 116(2) and (3)**. It is envisaged that the policy statement could include a set of trigger points as well as the circumstances when recommendations must or may be made.
- 2.24. **Regulation 116(5)** switches off the internal Local Government Pension Scheme Advisory Board process during any period when the employer cost cap under **Regulation 115** has been breached. This reflects Government policy that the

employer cost cap process will always take precedence over any internal cost management process. **(see Chapter 3 for connected policy question)**

- 2.25. **Regulation 116(6)** provides that the Local Government Pension Scheme Advisory Board must make recommendations to the Secretary of State where the overall cost of the Scheme exceeds the target overall cost by 2% or more.
- 2.26. **Regulation 116(7)** defines certain terms used in this regulation including :-
- “**the overall cost of the Scheme**” the total cost as calculated by the Scheme actuary as part of a Scheme cost assessment based on assumptions and a methodology determined by the Local Government Pension Scheme Advisory Board.
- “**the target overall cost**” set at 19.5% of the pensionable earnings of members of the Scheme, and
- “**the target proportion**” set at Scheme employers meeting two thirds and members meeting one third of the overall cost of the Scheme.
- 2.27. **Regulation 116(8)** requires each administering authority to provide the Scheme actuary with any data required to carry out valuations and produce reports for the purposes of this Regulation in accordance with directions from the Local Government Pension Scheme Advisory Board.
- 2.28. **Regulation 116(9)** requires the Local Government Pension Scheme Advisory Board to publish a report, including the items listed at **Regulation 116(9)(a) to (d)**, within 23 months of obtaining a Scheme cost assessment unless the Board is prevented from making recommendations to the Secretary of State by the provisions in **Regulation 116(5)**.
- 2.29. **Regulation 116(10)** requires a copy of the report published under **Regulation 116(9)** to be sent to the Secretary of State and Scheme actuary by the Local Government Pension Scheme Advisory Board.
- 2.30. **Regulation 116(11)** has been amended to extend the period required for the Secretary of State to publish his response to the report published by the Local Government Pension Scheme Advisory Board from 3 to 6 months of receiving the Scheme Advisory Board’s report. We believe that this represents a more appropriate timescale.

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## STATUTORY INSTRUMENTS

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2014 No. 0000

### PUBLIC SERVICE PENSIONS, ENGLAND AND WALES

# The Local Government Pension Scheme (Amendment) (Governance) Regulations 2014

<i>Made</i>	- - - -	2014
<i>Laid before Parliament</i>		2014
<i>Coming into force</i>	- -	2015

These Regulations are made in exercise of the powers conferred by sections 1, 3, 5(7), 7(2), 12(6) and 12(7) of, and Schedule 3 to, the Public Service Pensions Act 2013<sup>(1)</sup>.

In accordance with section 21 of that Act, the Secretary of State has consulted 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, interpretation, commencement and extent**

1.—(1) These Regulations may be cited as the Local Government Pension Scheme (Amendment) (Governance) Regulations 2014.

(2) In these Regulations “the Principal Regulations” means the Local Government Pension Scheme Regulations 2013<sup>(2)</sup>.

(3) These Regulations come in to force as follows—

- (a) on 1st January 2015, this regulation and regulations 2, 7 and 8—
  - (i) so far as they insert regulation 105 (delegation) into the Principal Regulations,

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<sup>(1)</sup> 2013 c. 25  
<sup>(2)</sup> S.I. 2013/2356.

- (ii) so far as they insert regulation 106 (local pension boards: establishment) into the Principal Regulations for the purposes of the obtaining of approval from the Secretary of State under paragraph (2) of that regulation, and
  - (iii) so far as they insert regulations 107 (local pensions boards: membership), 108 (local pensions boards: conflicts of interest), 110 (scheme advisory board: membership) and 111 (scheme advisory board: conflict of interest) for the purposes of appointment of members of local pension boards and the Local Government Pension Scheme Advisory Board; and
- (b) on 1st April 2015—
- (i) this regulation and regulations 2, 7 and 8 so far as not already commenced, and
  - (ii) the remainder of these Regulations.
- (4) These Regulations extend to England and Wales.

### **Amendment of the Local Government Pension Scheme Regulations 2013**

2. The Principal Regulations are amended in accordance with regulations 3 to 8.
3. Omit regulation 53(4) (scheme managers: establishment of pension board).
4. Omit regulation 63 (aggregate Scheme costs).
5. Omit regulation 65 (aggregate Scheme costs: revised certificates).
6. In regulation 66 (supply of copies of valuations, certificates etc) for “regulations 62 (actuarial valuations of pension funds), 64 (special circumstances where revised actuarial valuations and certificates must be obtained) or 65 (aggregate Scheme costs: revised certificates)” substitute “regulations 62 (actuarial valuation of pension funds) or 64 (special circumstances where revised actuarial valuations and certificates must be obtained)”.
7. In Schedule 1 (interpretation)—
  - (a) after the entry for “local government service” insert—
 

““Local Government Pension Scheme Advisory Board” means a board established under regulation 110 (Scheme advisory board: establishment);

“local pension board” means a board established under regulation 106 (local pension boards: establishment);”

and
  - (b) after the entry for “the Scheme” insert—
 

““Scheme actuary” means the actuary appointed under regulation 114 (Scheme actuary);”.
8. After regulation 104<sup>(3)</sup> insert—

## **“PART 3**

### **Governance**

#### **Delegation**

- 105.**—(1) The Secretary of State may delegate any functions under these Regulations.
- (2) Administering authorities may delegate any functions under these Regulations including this power to delegate.

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<sup>(3)</sup> Regulation 104 was inserted by S.I. 2014/1146.

### **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, and
  - (iii) any requirements imposed by the Pensions Regulator in relation to the Scheme; and
- (b) to ensure the effective and efficient governance and administration of the 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) Approval under paragraph (2) may be given subject to such conditions as the Secretary of State thinks fit.

(4) The Secretary of State may withdraw an approval if such conditions are not met or if in the opinion of the Secretary of State it is no longer appropriate for the local pension board to be the same committee.

(5) An administering authority may determine the procedures applicable to a local pension board, including as to voting rights, the establishment of sub-committees, formation of joint committees and payment of expenses.

(6) 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.

(7) 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 paragraphs (2) and (3) 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) A local pension board must include an equal number, which is no less than 4 in total, of employer representatives and member representatives<sup>(4)</sup> and for these purposes the administering authority must be satisfied that—

- (a) a person to be appointed as an employer representative has relevant experience and the capacity to represent employers on the local pension board; and
- (b) a person to be appointed as a member representative has relevant experience and the capacity to represent members on the local pension board.

(3) 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 a local pension board.

### **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>(5)</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.

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<sup>(4)</sup> See section 5(6) of the Public Service Pensions Act 2013 for definitions of these terms.

<sup>(5)</sup> See section 5(5) of the Public Service Pensions Act 2013 for the meaning of “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.

#### **Scheme advisory board: establishment**

**110.—**(1) A scheme advisory board (“the Local Government Pension Scheme Advisory Board”) is established.

(2) The Local Government Pension Scheme Advisory Board is responsible for providing advice to the Secretary of State on the desirability of making changes to the Scheme.

(3) The Local Government Pension Scheme Advisory Board is also responsible for providing advice to administering authorities and local pension boards in relation to the effective and efficient administration and management of the Scheme and any connected scheme and their pension funds.

(4) Subject to these Regulations, the Local Government Pension Scheme Advisory Board may determine its own procedures including as to voting rights, the establishment of sub-committees, formation of joint committees and the payment of remuneration and expenses.

(5) The Local Government Pension Scheme Advisory 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.

#### **Scheme advisory board: membership**

**111.—**(1) The Local Government Pension Scheme Advisory Board is to consist of a Chairman and at least 2, and no more than 12 members appointed by the Secretary of State.

(2) When deciding whether to make appointments under paragraph (1), the Secretary of State must have regard to the desirability of there being equal representation of persons representing the interests of Scheme employers and persons representing the interests of members.

(3) A member of the Local Government Pension Scheme Advisory Board is to hold and vacate office in accordance with the terms of that member’s appointment.

(4) The Chairman of the Local Government Pension Scheme Advisory Board may, with the agreement of the Board, appoint a maximum of 3 persons to be non-voting advisory members of the Board.

(5) An advisory member of the Local Government Pension Scheme Advisory Board is to hold and vacate that position in accordance with the terms of that member’s appointment.

(6) The Chairman of the Local Government Pension Scheme Advisory Board may, with the agreement of the Board, appoint persons who are not members of the Local Government Pension Scheme Advisory Board to be members of sub-committees of that Board.

(7) A member of a sub-committee of the Local Government Pension Scheme Advisory Board is to hold and vacate office in accordance with the terms of that member’s appointment.



### **Scheme advisory board: conflict of interest**

**112.**—(1) Before appointing any person to be a member of the Local Government Pension Scheme Advisory Board, the Secretary of State must be satisfied that the person does not have a conflict of interest<sup>(6)</sup>.

(2) The Secretary of State must be satisfied from time to time that none of the members of the Local Government Pension Scheme Advisory Board has a conflict of interest.

(3) A person who is to be appointed as a member of the Local Government Pension Scheme Advisory Board must provide the Secretary of State with such information as the Secretary of State reasonably requires for the purposes of paragraph (1).

(4) A person who is a member of the Local Government Pension Scheme Advisory Board must provide the Secretary of State with such information as the Secretary of State reasonably requires for the purposes of paragraph (2).

### **Scheme advisory board: funding**

**113.**—(1) The expenses of the Local Government Pension Scheme Advisory Board are to be treated as administration costs of the Scheme and are to be defrayed by the administering authorities within the Scheme in such proportions as are determined by the Board.

(2) The Local Government Pension Scheme Advisory Board must identify the amount to be paid by each administering authority towards its annual costs based on—

- (a) its annual budget approved by the Secretary of State; and
- (b) the number of persons for which the administering authority is the appropriate administering authority.

(3) An administering authority must pay the amount it is required to pay under this regulation at such time or times as the Local Government Pension Scheme Advisory Board may determine.

### **Scheme actuary**

**114.**—(1) The Secretary of State must appoint an actuary as Scheme actuary to carry out valuations of the Scheme in accordance with Treasury directions made under section 11 of the Public Service Pensions Act 2013<sup>(7)</sup> (“the Treasury directions”).

(2) The person appointed as Scheme actuary under paragraph (1) must, in the opinion of the Secretary of State, be appropriately qualified to carry out a valuation of the Scheme.

(3) The Secretary of State must secure that the Scheme actuary carries out actuarial valuations of the assets and liabilities of the Scheme on the dates specified in regulation 62(1)(a) (actuarial valuations of pension funds) and prepare valuation reports in accordance with the Treasury directions, within a time-frame which enables the requirements in those directions to be met.

(4) Administering authorities must provide the Scheme actuary with any data that the Scheme actuary reasonably requires, in accordance with the Treasury directions, in order to carry out a valuation and prepare a report on the valuation.

### **Employer cost cap**

**115.**—(1) The employer cost cap for the Scheme is []% of pensionable earnings of members of the Scheme.

(2) Where the cost of the Scheme, calculated following a valuation in accordance with Treasury directions under section 11 of the Public Service Pensions Act 2013 is more than the margins specified in regulations made under section 12(5) of the Public Service Pensions Act 2013<sup>(8)</sup> (“the Cost Cap

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<sup>(6)</sup> See section 7(5) of the Public Service Pensions Act 2013 for the meaning of “conflict of interest”.

<sup>(7)</sup> 2013 c. 25.

<sup>(8)</sup> 2013 c. 25; see regulation 3 of S.I. 2014/575.

Regulations”) above or below the employer cost cap, the Secretary of State must follow the procedure specified in paragraph (3) for reaching agreement with administering authorities, employers and members (or representatives of employers and members) as to the steps required to achieve the target cost specified in the Cost Cap Regulations.

(3) The procedure specified for the purposes of section 12(6)(a) of the Public Service Pensions Act 2013 is consultation for such period as the Secretary of State considers appropriate with the Local Government Pension Scheme Advisory Board with a view to reaching an agreement endorsed by all members of that Board.

(4) If, following such consultation, agreement is not reached within 3 months of the end of the consultation period, the Secretary of State must take steps to adjust the rate at which benefits accrue under regulation 23(4) or (5) (active member’s pension accounts) so that the target cost for the Scheme is achieved.

#### **Scheme advisory board: additional functions**

**116.**—(1) The Local Government Pension Scheme Advisory Board (“the Board”) must obtain a Scheme cost assessment from the Scheme actuary detailing the overall cost of the Scheme and the proportions of that cost being met by Scheme employers and members on the dates specified in regulation 62(1)(a) (actuarial valuations of pension funds).

(2) Subject to paragraphs (5) and (6), where the overall cost of the Scheme is above or below the target overall cost, the Board may make recommendations to the Secretary of State as to the steps to take to bring the overall cost of the Scheme back to the target overall cost.

(3) Where the proportion of the overall cost of the Scheme which is met by contributions by employers is above or below the target proportion, the Board may make recommendations to the Secretary of State as to the steps to take to bring the proportion of the overall cost of the Scheme which is met by contributions by employers and members back to the target proportion.

(4) The Board must, before obtaining a Scheme cost assessment under paragraph (1), prepare and publish a statement setting out its policy concerning recommendations to the Secretary of State about the steps to be taken to bring the overall cost of the Scheme back to the target overall cost and the proportions of that cost met by Scheme employers and members, back to the target proportion.

(5) The Board must not make recommendations under paragraph (2) if steps are required to be taken under regulation 115 (employer cost cap).

(6) Subject to paragraph (5) the Board must make recommendations under paragraph (2) if the overall cost of the Scheme is above or below the target overall cost by 2% or more of pensionable earnings of members.

(7) In this regulation—

“the overall cost of the Scheme” means the total cost as calculated by the Scheme actuary as part of a Scheme cost assessment making use of the data provided under regulation 114(4) (Scheme actuary) according to such methodology and assumptions as are determined by the Board;

“the target overall cost” is 19.5% of the pensionable earnings of members of the Scheme;

“the target proportion” means Scheme employers meeting two-thirds and members meeting one-third of the overall cost of the Scheme.

(8) Each administering authority must provide the Scheme actuary with any data that the Scheme actuary requires in order to carry out any valuations and produce reports in accordance with directions from the Board for the purposes of this regulation.

(9) Unless the Board is prevented by paragraph (5) from making recommendations under this regulation, it must, within 23 months of the date on which a Scheme cost assessment is obtained under paragraph (1), publish a report setting out—

- (a) the overall cost of the Scheme;
- (b) the proportions of the overall costs of the Scheme met by employers and members;
- (c) the assumptions and methodology used by the Scheme actuary; and
- (d) any recommendations made to the Secretary of State under this regulation.

(10) The Board must send a copy of a report published under paragraph (9) to the Secretary of State and the Scheme actuary.

(11) The Secretary of State must publish a response to a report received under paragraph (10) within six months of receipt of that report.

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)*

These Regulations amend the Local Government Pension Scheme Regulations 2013 (“the 2013 Regulations”) to make provision in respect of governance of the Scheme.

Regulation 1 commences the substantive provisions from 1st January 2015 for the purposes of making appointments to local pension boards and the Scheme Advisory Board, and brings the provisions fully into force from 1st April 2015.

Regulations 3 to 7 make minor amendments to the 2013 Regulations consequential to the substantive provisions.

Regulation 5 inserts a new Part 3 into the 2013 Regulations.

New regulation 105 permits the Secretary of State to delegate functions under the 2013 Regulations. It permits administering authorities to delegate their functions and also for any delegated function to be sub-delegated.

New regulations 106 to 109 make provision for each administering authority to establish a local pension board to assist it to comply with its legal obligations relating to the Scheme. Where a local authority discharges its pension functions through a committee, it can, with the approval of the Secretary of State appoint that existing committee to be the local pension board. Local pension boards must have equal representation of employer representatives and member representatives who must not be officers or councillors of the administering authority responsible for the discharge of local government pension functions.

Regulations 110 to 113 establish the Local Government Pension Scheme Advisory Board to advise the Secretary of State, administering authorities and local pension boards in relation to the Scheme. Provision is made for the appointment of members to the Board and for its funding.

Regulation 114 requires the Secretary of State to appoint a Scheme actuary to carry out valuations of the Scheme.

Regulation 115 sets the employer cost cap and requires the Secretary of State to seek agreement from those affected as to the changes to the design of the Scheme necessary to bring costs back to that level if valuation reports indicate that costs have varied by more than a margin specified in regulations made by the Treasury. If agreement can not be reached the Secretary of State must make amendments to the Scheme to vary the rate of accrual of benefits to bring the costs of the Scheme back to the employer cost cap level.

Regulation 116 confers additional functions on the Local Government Pension Scheme Advisory Board to monitor the overall costs of the Scheme and the proportion of those costs met by employers and members

respectively and to make recommendations to the Secretary of State for changes to the Scheme where overall costs or respective proportions met by employer or member contributions vary from the initial costs.



# **Local Government Pension Scheme Draft Guidance on the creation and operation of Local Pension Boards in England and Wales**

## **For Consultation**



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## 1. Introduction

- 1.1 The LGPS is a common pension scheme throughout England and Wales, administered locally by 88 separate Administering Authorities.
- 1.2 In the context of the UK public service pension schemes, the LGPS is the largest funded occupational pension scheme in the UK.
- 1.3 Administering Authorities are required to establish a new body to be known as a Local Pension Board to assist the Administering Authority in its role as the Scheme Manager of its Fund in accordance with the requirements of the 2013 Act.
- 1.4 This Guidance is designed to assist Administering Authorities in the creation and operation of Local Pension Boards in line with relevant legislation and in particular the 2013 Act and the Regulations.
- 1.5 This Guidance should not be taken as a definitive interpretation of legislation and it should always be read in conjunction with the relevant legislation. Administering Authorities are advised to secure their own legal advice on the interpretation and application of the legal framework.
- 1.6 Unless otherwise stated, this Guidance is correct as at *[Insert date when final guidance published]*.
- 1.7 The following is an explanation of defined terms used in this Guidance:

<b>1972 Act</b>	The Local Government Act 1972.
<b>1989 Act</b>	The Local Government & Housing Act 1989.
<b>2000 Act</b>	The Local Government Act 2000.
<b>2004 Act</b>	The Pensions Act 2004.
<b>2011 Act</b>	The Localism Act 2011.
<b>2013 Act</b>	The Public Service Pensions Act 2013.
<b>Administering Authority</b>	Bodies listed in Part 1 of Schedule 3 of the Regulations who maintain a fund within the LGPS.
<b>Code of Practice</b>	The Regulator's [draft] Code of Practice no. 14 entitled " <i>Governance and administration of public</i>

	<i>service pension schemes”.</i>
<b>DCLG</b>	The Department for Communities and Local Government
<b>DPA</b>	Data Protection Act 1998
<b>FOIA</b>	Freedom of Information Act 2000
<b>Investment Regulations</b>	The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.
<b>IPSPC</b>	Independent Public Service Pensions Commission.
<b>LGPS</b>	The Local Government Pension Scheme - a scheme for the payment of pensions and other benefits to or in respect of persons working in local government service in England and Wales or for other bodies that participate in the LGPS.
<b>Local Pension Board</b>	The board established to assist the Administering Authority as the Scheme Manager for each Fund.
<b>Pension Committee</b>	Committees or sub-committees to which an Administering Authority has delegated its pension function.
<b>Regulations</b>	The Local Government Pension Scheme Regulations 2013 (as amended).
<b>Regulator</b>	The Pensions Regulator.
<b>Responsible Authority</b>	The Secretary of State for Communities and Local Government being the person who makes regulations for a pension scheme established under section 1 of the 2013 Act.
<b>Rules of Procedure</b>	The rules governing the decision making process of the Administering Authority as set out in its constitution.



<b>Scheme Advisory Board</b>	The Local Government Pension Scheme Advisory Board established under the Regulations.
<b>Scheme Manager</b>	A person or body responsible for managing or administering a pension scheme established under section 1 of the 2013 Act. In the case of the LGPS, each Fund has a Scheme Manager which is the Administering Authority.
<b>Secretary of State</b>	The Secretary of State for Communities and Local Government.
<b>Transitional Regulations</b>	The Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014.

## **2. Background**

### **LGPS Governance Structure Prior to April 2015**

- 2.1 The LGPS is a statutory funded public service pension scheme. It differs in legal status from trust based pension schemes in the private sector because it is established under statute and not set up under a trust. It also differs from most other statutory public service pension schemes which are unfunded schemes. Matters of governance in the LGPS therefore need to be considered on their own merits and with proper regard to the unique legal status of the LGPS.
- 2.2 Prior to 1 April 2015, the LGPS has had a relatively straightforward governance structure which includes the Secretary of State and the Administering Authority.
- 2.3 Each Administering Authority is responsible for managing and administering the LGPS in relation to any person for which it is the appropriate administering authority under the Regulations. The Administering Authority is responsible for maintaining and investing its own Fund within the LGPS.
- 2.4 How an Administering Authority delegates its LGPS function is largely a matter for each Administering Authority. The majority of Administering Authorities are local authorities and therefore operate in accordance with local government law. However some Administering Authorities are not local authorities such as the Environment Agency, the London Pensions Fund Authority and the South Yorkshire Pensions Authority. Such bodies operate in accordance with their own legal constitutions.

### **The Road to Reform**

- 2.5 June 2010: Lord Hutton of Furness is appointed by Government to chair the IPSPC and undertake a fundamental structural review of public service pension provision and to make recommendations to the Chancellor and Chief Secretary to the Treasury on future pension arrangements.
- 2.6 October 2010: The IPSPC produces its interim report.
- 2.7 March 2011: The IPSPC produces its final report making 27 recommendations for the reform of public service pension schemes including:

- properly constituted, trained and competent pension board with member nominees, responsible for meeting good standards of governance including effective and efficient administration;
- a pension policy group for each public service pension scheme at national level for considering major changes to scheme rules; and
- independent oversight of the governance, administration and data transparency of public service pension schemes.

- 2.8 December 2011: Following a meeting in November 2011, the Local Government Association and lead members and officials from GMB, UNISON and Unite conclude that discussions should be progressed with the aim of reaching agreement on a set of high level principles for the LGPS.
- 2.9 May 2012: The Local Government Association, GMB, UNISON and Unite announce the outcome of their negotiations on new LGPS proposals to take effect from 1 April 2014.
- 2.10 April 2013: The 2013 Act implementing most of the IPSPC's recommendations receives Royal Assent.
- 2.11 April 2014: The new career-average LGPS comes into force.
- 2.12 April 2015: The new governance structure for the LGPS and other public service pension schemes come into force.

### **3. Legislative background and structure of governance arrangements from 2015**

#### **Legislative requirements for governance in the LGPS**

- 3.1 The Regulations require each Administering Authority to establish a Local Pension Board for the purposes of assisting the Administering Authority in line with the requirements set out in paragraph 3.27.
- 3.2 Local Pension Boards must be established no later than 1 April 2015. Established in this context means that the Administering Authority must have approved the establishment of the Local Pension Board and its composition and also the terms of reference, in accordance with its constitution. It does not necessarily mean that the Local Pension Board has to be fully operational by this date. However, it is anticipated that a Local Pension Board should be operational within a reasonably practicable period after 1 April 2015 (being no longer than 4 month). An Administering Authority may establish its Local Pension Board earlier from [1 January 2015].
- 3.3 The Regulations set out the requirements relating to the new Local Pension Boards.

#### **Governance structure in the LGPS**

- 3.4 Each Administering Authority is responsible for managing and administering the LGPS in relation to any person for which it is the appropriate administering authority under the Regulations. The Administering Authority is responsible for maintaining and investing its own Fund for the LGPS.
- 3.5 Administering Authorities are defined in Part 1 of Schedule 3 of the Regulations.
- 3.6 The majority of Administering Authorities are local authorities and therefore operate in accordance with local government law requirements. However some Administering Authorities are not local authorities such as the Environment Agency, the London Pensions Fund Authority and the South Yorkshire Pensions Authority. Such bodies operate in accordance with their own legal constitutions.
- 3.7 In some instances, two or more Administering Authorities may share their administration function, for example through a shared service arrangement, or in other ways. However, where this happens each local authority still

retains its own individual Administering Authority status and therefore legal responsibility for its own Fund.

3.8 The membership structure for the Local Pension Board required by regulation 107 of the Regulations does not fit neatly into the standard arrangements which exist for decision making on pensions issues and existing established governance arrangements for Administering Authorities. This section of the Guidance sets out the general legal provisions which will assist in placing the Local Pension Board in the context of decision making on wider pensions and financial matters.

3.9 For local authority Administering Authorities it is not permissible for decisions about pension allowances or the amount of pension to be paid to employees to be an executive decision (see The Local Authorities (Functions and Responsibilities) (England) Regulations 2000 and The Local Authorities Executive Arrangements (Functions and Responsibilities) (Wales) Regulations 2001. This means that the executive (usually cabinet or the elected mayor) cannot make decisions in relation to LGPS matters, for example, how to exercise discretions under the Regulations.

3.10 This means in practice that decisions about pensions are delegated in accordance with Section 101 of the 1972 Act to:

3.10.1 committees or sub-committees made up of councillors from all the political groups and will be politically balanced; or

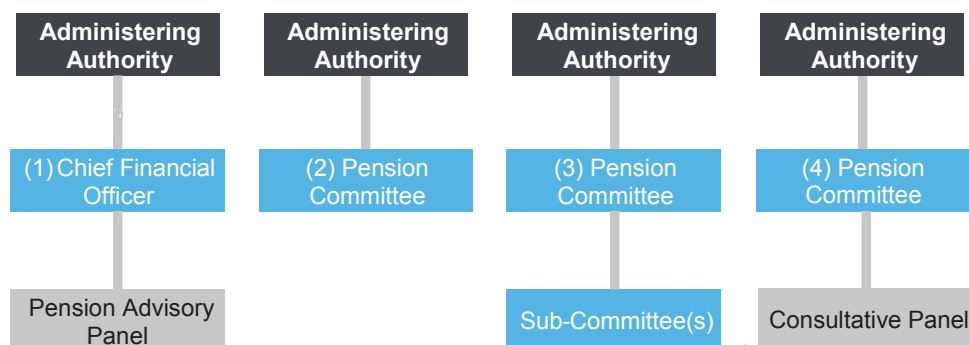
3.10.2 officers.

Some decisions will be reserved for full council, for example decisions which have an impact on the budget.

3.11 Regulation 105 also provides that Administering Authorities may delegate functions under the Regulations. This confirms the authority in Section 101 of the 1972 Act.

3.12 The delegation of pension functions varies from Administering Authority to Administering Authority depending on local circumstances. The Regulations require an Administering Authority's governance compliance statement to set out whether the Authority delegates its functions and the detail of the delegation given. This includes the terms, structure and operation of the delegation, the frequency of meetings and membership and voting rights.

- 3.13 Common delegation structures used by Administering Authorities can be summarised as follows:



### **Governance compliance statements**

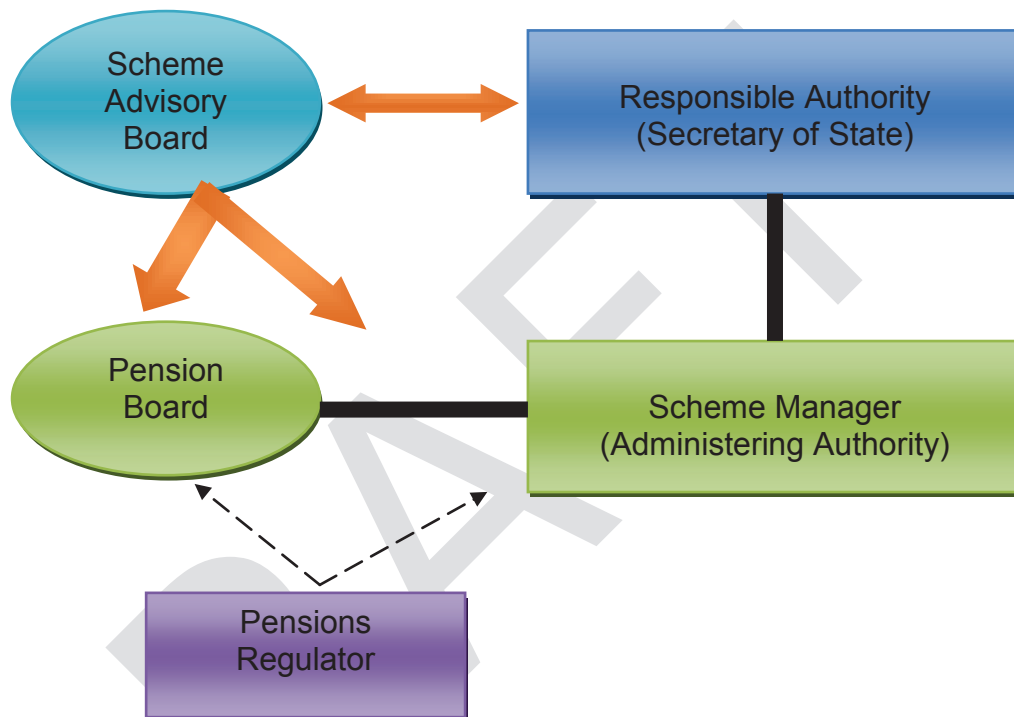
- 3.14 To ascertain how an individual Administering Authority actually delegates its pension function it is necessary to review its governance compliance statement. Each Administering Authority must have in place a statement setting out whether the Administering Authority delegates its functions, or part of its functions under the Regulations to a committee, a sub-committee or an officer of the authority.
- 3.15 Where the Administering Authority does delegate its functions, the statement must include:
- 3.15.1 the terms, structure and operational procedures of the delegation;
  - 3.15.2 the frequency of any committee or sub-committee meetings;
  - 3.15.3 whether such a committee or sub-committee includes representatives of scheme employers or members, and if so, whether those representatives have voting rights;
  - 3.15.4 the extent to which a delegation, or the absence of a delegation, complies with guidance given by the Secretary of State and, to the extent that it does not so comply, the reasons for not complying; and
  - 3.15.5 details of the terms, structure and operational procedures relating to the Local Pension Board.
- 3.16 Current governance compliance statements will need to be revised to include the new information referred to at paragraph 3.15.5. The

Administering Authority will firstly need to consult with such persons as it thinks necessary about the revised statement and then publish it once it has been revised.

### **New governance structure in the LGPS**

- 3.17 From 1 April 2015, the new governance structure of the LGPS can be summarised in the following diagram:

#### **Post April 2015 LGPS Governance Structure**



### **The Responsible Authority**

- 3.18 In accordance with section 2 of the 2013 Act, each pension scheme established under section 1 of the 2013 Act must have a 'responsible authority' which is the person who may make regulations for that scheme.
- 3.19 In the case of the LGPS, the Responsible Authority is the Secretary of State.

### **Administering Authority/Scheme Manager**

- 3.20 Section 4 of the 2013 Act requires that, in the case of a pension scheme established under section 1 of that Act, regulations must provide for a 'scheme manager'. The scheme manager is the person who is responsible for managing or administering the scheme.

- 3.21 The Regulations specify that the ‘scheme manager’ responsible for the local administration of pensions and other benefits payable under the LGPS shall be each Administering Authority.
- 3.22 In the case of the LGPS, each Fund therefore has a Scheme Manager which is the Administering Authority. This contrasts with other public service pension schemes administered on a national basis, such as the Teachers’ Pension Scheme, where there is a single scheme manager for the whole scheme.
- 3.23 As noted at paragraph 3.4 an Administering Authority is responsible for managing and administering the LGPS in relation to any person for which it is the appropriate administering authority under the Regulations. The Administering Authority is responsible for maintaining and investing its own Fund for the LGPS. This means the Administering Authority is responsible for making all decisions relating to the operation of the Fund.
- 3.24 The creation of new Local Pension Boards does not change the core role of the Administering Authority or the way it delegates its pension functions. However, when establishing its Local Pension Board, the Administering Authority may wish to take the opportunity to review its current delegation structure to see if it remains fit for purpose.
- 3.25 For example, where there is an advisory panel advising a Pension Committee, the Administering Authority may wish to consider the extent to which the advisory panel’s functions are superseded by the new Local Pension Board. An existing panel of this nature is not a Local Pension Board and should not be re-badged as such. A new Local Pension Board should be properly established and the existing arrangements then reviewed.

### **Local Pension Boards**

- 3.26 Section 5 of the 2013 Act requires that, in the case of a pension scheme established under section 1 of that Act, regulations must provide for the establishment of a board with responsibility for assisting the scheme manager(s) in relation to specified matters. In turn, this has resulted in the requirement for Local Pension Boards for each Fund in the LGPS under the Regulations.



3.27 Regulation 106(1) of the Regulations specifies that each Administering Authority shall establish its own Local Pension Board with responsibility for assisting the Administering Authority:

3.27.1 to secure compliance with:

3.27.1.1 the Regulations;

3.27.1.2 other legislation relating to the governance and administration of the LGPS; and

3.27.1.3 the requirements imposed by the Regulator in relation to the LGPS, and

3.27.2 to ensure the effective and efficient governance and administration of the LGPS.

3.28 Assisting the Administering Authority should be interpreted as helping the Administering Authority, including doing work requested by the Administering Authority. However, the Local Pension Board does not replace the Administering Authority or make decisions which are the responsibility of the Administering Authority.

3.29 The remit of the Local Pension Board should be interpreted as covering all aspects of governance and administration of the LGPS, including funding and investments.

3.30 Regulation 106(7) of the Regulations specifies that the expenses of a Local Pension Board shall be regarded as part of the costs of administration of the Fund. This is considered in more detail in section 9, Resourcing and Funding.

### **Scheme Advisory Board**

3.31 Section 7 of the 2013 Act requires that, in the case of a pension scheme established under section 1 of that Act, regulations must provide for the establishment of a board with responsibility for providing advice to the responsible authority, at the authority's request, on the desirability of changes to the scheme. The responsible authority must have regard to such advice.

3.32 Where a scheme has more than one scheme manager (and accordingly there is more than one pension board for 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 in relation to the effective and efficient administration and management of the scheme or any pension fund of the scheme.

3.33 In turn, Section 7 has resulted in the requirement for the Scheme Advisory Board for the LGPS under the Regulations. The Scheme Advisory Board for the LGPS is established by the Regulations and is responsible for providing advice:

3.33.1 to the Secretary of State on the desirability of making changes to the LGPS; and

3.33.2 to the Administering Authorities and Local Pension Boards in relation to the effective and efficient administration and management of the LGPS and the Funds.

3.34 In both cases, the Secretary of State and Administering Authorities or Local Pension Boards must have regard to advice issued by the Scheme Advisory Board in accordance with section 7(3) of the 2013 Act.

#### **4. The Pensions Regulator**

- 4.1 The regulatory powers of the Regulator were extended under section 17 and Schedule 4 of the 2013 Act to cover some aspects of public service pension schemes, including the LGPS.
- 4.2 The Regulator is an existing body corporate established by the 2004 Act. Prior to 1 April 2015, the Regulator regulated occupational and personal pension schemes provided primarily through private sector employers.
- 4.3 The Regulator has a number of statutory objectives including to:
  - 4.3.1 protect the benefits of pension scheme members,
  - 4.3.2 promote, and improve understanding of, the good administration of work-based pension schemes; and
  - 4.3.3 maximise compliance with the duties and safeguards of the Pensions Act 2008.
- 4.4 The 2013 Act introduces a framework for the regulatory oversight of aspects of the governance and administration of public service pension schemes by the Regulator from 1 April 2015, through expanding its current role.
- 4.5 The Regulator has oversight in areas such as those listed in paragraph 4.6 below and may issue codes of practice for public service pension schemes in these areas.
- 4.6 The Regulator has issued the [Draft] Code of Practice which covers:
  - 4.6.1 knowledge and understanding by pension board members (see paragraphs 32 to 56 of the Code of Practice);
  - 4.6.2 conflicts of interest (see paragraphs 57 to 84 of the Code of Practice);
  - 4.6.3 reporting breaches of the law (see paragraphs 230 to 263 of the Code of Practice);
  - 4.6.4 information to be published about a scheme (see paragraphs 85 to 92 of the Code of Practice);
  - 4.6.5 internal controls (see paragraphs 93 to 112 of the Code of Practice);

- 4.6.6 scheme record-keeping (see paragraphs 114 to 139 of the Code of Practice);
  - 4.6.7 maintaining contributions (see paragraphs 140 to 182 of the Code of Practice);
  - 4.6.8 information to be provided to members (see paragraphs 183 to 201 of the Code of Practice) ; and
  - 4.6.9 internal dispute resolution (see paragraphs 203 to 229 of the Code of Practice).
- 4.7 However, only the areas of knowledge and understanding, conflicts of interest and reporting breaches of the law have direct application to Local Pension Boards. The other areas apply to Administering Authorities, although are areas that a Local Pension Board will need to be aware of in order to assist the Administering Authority.
- 4.8 This Guidance takes into account the principles of the Code of Practice where relevant and applies them to the LGPS.
- 4.9 For the avoidance of doubt the powers of the Regulator were not extended to cover areas such as the funding and investment of Funds.

### **The Regulator's Powers**

- 4.10 The Regulator will have a range of enforcement powers under the 2013 Act including:
- 4.10.1 the power to appoint a person to assist a Local Pension Board in the discharge of its functions if the Regulator considers it desirable for the purpose of ensuring compliance with relevant “pensions legislation”;
  - 4.10.2 the power to issue an ‘improvement notice’ to an Administering Authority or to a member(s) of a Local Pension Board directing them to take, or refrain from taking, such steps as are specified in the notice in order to remedy or prevent a recurrence of a contravention of “pensions legislation”;
  - 4.10.3 the power to issue a ‘third party notice’ directing a third party to take, or refrain from taking, such steps as are specified in the notice in order to remedy or prevent a recurrence of a contravention of “pensions legislation”;

- 4.10.4 the power to issue a 'report notice' to an Administering Authority or to a member(s) of a Local Pension Board requiring them to provide a report on a specified matter(s) which are relevant to the exercise of any of the Regulator's functions;
  - 4.10.5 the power to require Administering Authorities and members of Local Pension Boards to produce documents and information;
  - 4.10.6 the power to inspect premises;
  - 4.10.7 the power to apply for an injunction;
  - 4.10.8 the power to apply for restitution where there has been a misuse or misappropriation of any Fund assets;
  - 4.10.9 the power to recover unpaid contributions on behalf of an Administering Authority; and
  - 4.10.10 the power to impose civil penalties for breaches of certain pensions legislation including the duty for Administering Authorities and members of Local Pension Boards to report breaches of the law, the duty for Administering Authorities to report the late payment of employer contributions and the failure to comply with an 'improvement notice' or a 'report notice'.
- 4.11 As noted above, certain powers of the Regulator are limited to contravention of "pensions legislation". For this purpose, "pensions legislation" has a specific meaning and includes certain pieces of core pensions legislation which apply to both public and private sector schemes (the Pension Schemes Act 1993; parts of the Pensions Act 1995; the Pensions Act 2004; and statutory provisions on pension sharing on divorce). In terms of the legislation contained in the 2013 Act, "pension legislations" only includes sections 5(4) (pension board: conflicts of interest and representation), 6 (pension board: information), 14 (information about benefits) and 16 (records).
- 4.12 Of the 2013 Act provisions, only section 5(4) (pension board: conflicts of interest and representation) has direct relevance to a Local Pension Board, as the other sections relate to Scheme Manager responsibilities.
- 4.13 The other listed statutory provisions are relevant to the extent that a Local Pension Board is responsible for assisting the Administering Authority to comply with legislation relating to the governance and administration of the

LGPS (which will include certain elements of the listed statutes). In all cases, the term “pensions legislation” covers both the statutory provisions listed and any secondary legislation made under those provisions.

### **Reporting Local Pension Members to the Administering Authority**

4.14 If the Regulator has reasonable grounds to suspect or believe that a member of a Local Pension Board:

4.14.1 has misappropriated any assets of the Fund or is likely to do so;  
or

4.14.2 has a conflict of interest in relation to the investment of assets of the Fund

the Regulator must report the matter to the Administering Authority. However, given that a member of Local Pension Board should not have access to Fund assets or be involved in the investment of Fund assets then the exercise of this duty should be rare in practice.

## **5. Constitution and Membership of a Local Pension Board**

- 5.1 As noted at paragraph 3.2, Local Pension Boards must be established no later than 1 April 2015. Established in this context means that the Administering Authority must have approved the establishment of the Local Pension Board and the Local Pension Board's composition and also the terms of reference, in accordance with its constitution. It does not necessarily mean that the Local Pension Board has to be fully operational by this date. However, it is anticipated that a Local Pension Board should be operational within a reasonably practicable period after 1 April 2015 (being no longer than 4 month). An Administering Authority may establish its Local Pension Board earlier from [1 January 2015].
- 5.2 The responsibility for establishing a Local Pension Board rests with the Administering Authority of each Fund. This is something the Administering Authority must do, it is not optional.
- 5.3 For many Administering Authorities, all existing pension functions are likely to be delegated to a Pension Committee or an officer. However, it is open to an Administering Authority to exercise directly any function which it has delegated.
- 5.4 In light of the fact that the role of the Local Pension Board is to assist the Administering Authority, the Administering Authority will need to carefully consider whether the establishment of the Local Pension Board and appointment of its members should be a function undertaken by the Administering Authority (for example full council) rather than by the delegated Pension Committee or officer.
- 5.5 An Administering Authority is given power under regulation 106(5) of the Regulations to determine the procedures applicable to its Local Pension Board, including voting rights, the establishment of sub-committees and the payment of expenses. When exercising this power (as provided for in the 2013 Act), the Administering Authority must do so in accordance with usual local government principles, acting reasonably and within the powers set out in the Regulations.
- 5.6 Regulation 106(2) of the Regulations provides that where a local authority Administering Authority delegates its pension functions to a Pensions Committee, then with Secretary of State approval, the Pensions Committee may also undertake the role of the Local Pension Board. Please see section 10 of this guidance for further details.

## **Membership of a Local Pension Board**

- 5.7 A Local Pension Board must include an equal number of employer and member representatives with a minimum requirement of no less than four in total. In addition, the Regulations do not preclude that other members may also be appointed to the Board.
- 5.8 No officer or councillor of an Administering Authority who is responsible for the discharge of any function under the Regulations (apart from any function relating to Local Pension Boards or the Scheme Advisory Board) may be a member of a Local Pension Board.
- 5.9 When considering the size of its Local Pension Board, the Administering Authority will need to consider a number of factors including (without limitation):
- 5.9.1 The size of any existing governing bodies, such as an advisory panel;
  - 5.9.2 The number of scheme members and the number and size of employers within the Fund and any collective arrangements in place for them to make decisions or provide input in relation to Fund matters;
  - 5.9.3 The cost of establishing and operating the Board; and
  - 5.9.4 The existence or proposal to form any other advisory groups.
- 5.10 As indicated in the Regulator's code of practice the Administering Authority should consider providing high quality pre-appointment training to proposed members of the Local Pension Board.

## **Appointment of Local Pension Board Members**

- 5.11 Each employer or member representative on a Local Pension Board will potentially represent a significant range of employers or members (as appropriate). It is therefore important that the methodology for appointment ensures that representative Board members are truly representative.
- 5.12 All employers and members within a Fund must have equal opportunity to be nominated for the role of employer or member representative through an open and transparent process.



- 5.13 The Regulations also allow for the appointment of other members i.e. members who are not there to represent employers or scheme members, for example where an Administering Authority wishes to appoint an independent chairperson to the Local Pension Board.

#### **Relevant Experience and Capacity of Representative Members**

- 5.14 Regulation 107 of the Regulations also requires that the Administering Authority must ensure that any person it wishes to appoint as an employer or member representative has relevant experience and the capacity to represent the employers or members (as appropriate) of the Fund.
- 5.15 It will be important to appoint members who have the relevant experience as well as time to commit to attending meetings and effectively representing employers and members (as appropriate).
- 5.16 Relevant experience may include (without limitation) being a member of the LGPS or being a member or trustee of a private sector defined benefit pension scheme.
- 5.17 The Regulations specify a Local Pension Board member should not have a conflict of interest, and then go on to clarify that a financial or other conflict of interest will not arise merely by virtue of a member of a Local Pension Board being a member of the LGPS and/or Fund. The potential for conflicts of interest is considered in section 7 of this of this guidance.
- 5.18 An individual's ability to properly represent the interests of employers or members (as appropriate) and channel information back to those persons effectively should also be a key factor in selecting members of the Local Pension Board. This needs to take account of the wide range of membership of the Fund to ensure all employers and members are represented.

#### **Appointment of Other Members**

- 5.19 As noted at paragraph 5.8, no officer or councillor of an Administering Authority who is responsible for the discharge of any function under the Regulations (apart from any function relating to Local Pension Boards or the Scheme Advisory Board) may be a member of a Local Pension Board.
- 5.20 The requirement for relevant experience and capacity do not apply to other (i.e. non-representative) members appointed by the Administering Authority.

Nevertheless, the Administering Authority should have an open and transparent process for the appointment of such members.

- 5.21 Relevant experience and capacity are likely to be factors an Administering Authority will take into account when considering who to appoint as non-representative Board members.

### **The Process for Appointing Employer and Member Representatives**

- 5.22 The methodology for appointing employer and member representatives is not prescribed by the Regulations. It will therefore fall to each Administering Authority to establish an appropriate process. Options may include (but are not limited to):

#### **Direct Appointment Process**

- 5.22.1 Selecting employer representatives through existing employer forums, for example nominations and voting at employer AGMs.
- 5.22.2 Selecting member representatives through existing representative organisations for example recognised trade unions, staff committees, member representative committees, pensioner organisations or nominations and voting at member AGMs.

#### **Two Stage Nomination and Selection Process**

- 5.22.3 Administering authorities may wish to consider methodologies used by private sector trust based schemes to appoint member-nominated trustees (“MNTs”). MNTs must be:
- 5.22.3.1 nominated as the result of a process which includes at least all the active and pensioner members of the scheme (or an organisation which adequately represents them); and
  - 5.22.3.2 selected as a result of a process which involves some or all of the members of the scheme.
- 5.22.4 Seeking nominations by advertising in local newspapers and on websites.
- 5.22.5 Developing a shared pool of Local Pension Board members or potential members with neighbouring Administering Authorities.

- 5.22.6 Encouraging partner organisations or contractors to nominate members.
- 5.23 The appointment process should be designed to attract people with relevant experience. This could be achieved through publicising the new role and when making future appointments, publicising vacancies as they arise. Administering Authorities should use a variety of routes to encourage people to become involved. Role descriptions should be created to assist with assessing whether an individual has the relevant experience and capacity for the role.
- 5.24 When selecting members, proper regard must be given to the obligations of the Administering Authority in relation to equal opportunities in any recruitment process. In practice, this means having an open transparent process, with a role specification. Depending on the appointment process used by the Administering Authority, it may also be necessary to have a formal interview process before appointments are made. The interview process should assess the ability of the individual to meet the requirements of the role and make appointment on merit.
- 5.25 It is also important to ensure that those who are appointed have a range of experience so that there is a good balance and breadth of experience on the Local Pension Board.

### **Making Appointments**

- 5.26 As noted in other sections, the appointment process provides an ideal opportunity for the Administering Authority to obtain confirmation from the appointee in the form of a written undertaking that they understand the requirements of the role and to commit to those requirements, for example by:
- 5.26.1 disclosing all dual interests and responsibilities which have the potential to become conflicts of interest (see paragraph 7.36);
  - 5.26.2 committing to attend a minimum number of meetings a year;
  - 5.26.3 committing to undertake and attend the necessary knowledge and understanding training (see paragraph 6.22); and
  - 5.26.4 undertaking to abide by the Board's terms of reference and wider constitutional documents.

## **Term of Office**

- 5.27 Consideration should be given to the term of office so that experience is retained on the Local Pension Board. This could be by a proportion of members retiring on a rolling basis so that the Local Pension Board has the benefit of gaining new members with new experience whilst also retaining existing experienced members and stability for the Local Pension Board.
- 5.28 The ability of members to seek re-appointment for a further term needs to be considered. Given the complexity of the subject matter there is a case for renewing membership over an extended period.

## **Termination**

- 5.29 As well as dealing with the terms of appointment, the Administering Authority should also consider the circumstances in which a member of a Local Pension Board should cease to be a member.
- 5.30 Clearly this will arise at the expiry of a member's term of office, although there may well be other circumstances in which a member's term of office may end, for example the Administering Authority should consider suitable provisions if:
- 5.30.1 A member has a conflict of interest which cannot be managed in accordance with the Board's conflicts policy;
  - 5.30.2 a member dies or becomes incapable of acting;
  - 5.30.3 a member who is a councillor of the Administering Authority is appointed to a Pensions Committee;
  - 5.30.4 a member is appointed to the role of an officer of the Administering Authority with responsibility for the discharge of functions under the Regulations;
  - 5.30.5 a member wishes to resign, for example how much notice should be given and in what form;
  - 5.30.6 a representative member ceases to represent his constituency, for example if an employer representative leaves the employment of his employer and therefore ceases to have the capacity to represent the Fund's employers; and

5.30.7 a member fails to attend meetings or otherwise comply with the requirements of being a Board member, for example fails to attend the necessary knowledge and understanding training. The Administering Authority should consider who would decide this, whether the member should be given an opportunity to change their behaviour and how much notice should be given and in what form. Where issues of this nature arise, the chair of the Local Pension Board should have lead responsibility for an initial informal discussion with the member about the concerns. It would be helpful for the chair of the Local Pension Board to be supported and advised by professional advisers with that discussion. This could be an Administering Authority officer provided there was no conflict of interest. The matter could also be raised with any body which had nominated the individual for appointment.

5.31 Where a vacancy arises for a representative member mid-term, the Administering Authority should consider the process to be used to fill that vacancy.

#### **Terms of Reference**

5.32 The Administering Authority when establishing its Local Pension Board should create terms of reference for the Board on the basis that the Board is a stand-alone body. The terms of reference are the rules setting out how the Board will be constituted and operate on a day to day basis.

5.33 It is worth noting that under regulation 106(6) of the Regulations a Local Pension Board shall have the general power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions. However, as a minimum a Board's terms of reference should include areas such as:

5.33.1 **Function of the Board** – The terms should set out the function of the Board to assist the Administering Authority to secure compliance and ensure the effective and efficient governance and administration of the LGPS in line with the requirements set out at paragraph 3.27.

5.33.2 **Membership** – This should include the number of each category of Board member (including other representatives), the appointment and selection process, term of office and procedures for termination of office.

- 5.33.3 **Code of Conduct** – The terms of reference should refer to the requirement for the Local Pension Board to have a code of conduct for its members and that members of the Board should abide by the code (see paragraph 7.9).
- 5.33.4 **Voting Rights** – The terms should set out the voting rights of the Board members and whether members have equal voting rights and whether the chair (if relevant) has a casting vote.
- 5.33.5 **Conflict of Interests** – The terms should refer to the requirement for the Board to always act within the terms of reference. The Local Pension Board should have a conflicts policy for its members and that members should abide by the policy and provide information that the Administering Authority may reasonably require from time to time to ensure that members do not have a conflict of interest (see paragraph 7.40).
- 5.33.6 **Appointment of a Chair/Vice-Chair** – The terms should specify whether the Board is to have a chair and/or vice-chair and if so specify the roles of the chair and/or vice-chair, how they are appointed and whether the chair is to be given a casting vote. This should include the leadership responsibilities of the chair to ensure that meetings are properly conducted, decision making is clear and professional advice is followed. It will also set out the role of the chair in agreeing the agenda and approving the minutes for each meeting.
- 5.33.7 **Role of Advisors** – The terms should set out the role of professional advisers, or other advisors to the Board and the process for their appointment and agreeing their fees. In addition the process for the Board accessing existing advisors to the Administering Authority should also be set out. Administering Authorities may wish to use a shared pool of potential members (as set out in paragraph 5.22.5), for example having access to an agreed pool of senior pension fund officers from other (possibly neighbouring) authorities.
- 5.33.8 **Role of Officers** – The terms should set out the role of officers of the Administering Authority to the Board, for example in the provision of secretariat services to the Board or providing pension fund information to the Board.

- 5.33.9 **Administration, Papers, Communication and Obtaining Information** – The terms should specify the terms for notice of Board meetings, the circulation of papers in advance of meetings, how meetings are to be run, the decision making process, recording minutes of meetings, a procedure for dealing with urgent items of business and the publication of information if considered relevant. In addition where specific information may be required by the Board details of where such information may be obtained from should be provided to the Board. As a committee of the Administering Authority which is a FOIA public authority, minutes should be carefully dealt with and separated as appropriate into open and closed business, so that open minutes can be promptly published in the Administering Authority's FOIA publication scheme (see paragraph 8.20 to 8.21 for further details).
- 5.33.10 **Number of Meetings** – The terms should specify whether there should be a minimum number of meetings in a year. The frequency of Pension Committee meetings may serve as a useful benchmark for how often the Board should meet. There should also be an ability for a specified number of Board members or the Administering Authority to require a special meeting to be convened on notice.
- 5.33.11 **Location and time of meetings** – The terms should specify any restrictions in relation to the time (for example, during working hours only), and location of meetings and whether the meetings are to be public or not. Decisions about the time and location of meetings should be made whilst also being aware of the capacity requirements placed upon Board members.
- 5.33.12 **Quorum** – The terms should specify a quorum for meetings and in particular whether the quorum should include a minimum number of employer and member representatives.
- 5.33.13 **Attendance Requirements** – The terms should specify the requirements for attending meetings and the consequences of continued failure to attend Board meetings.
- 5.33.14 **Role of Substitutes** – The terms should specify whether members are allowed to send substitutes to meetings where they are unable to attend themselves. This may be more appropriate for employer



and member representatives. Training requirements should also be considered where substitutes are permitted.

**5.33.15 Creation of Working Groups/Sub-Boards** – The terms should specify whether the Board has the power to set up working groups or sub-boards and if so on what terms (including terms of reference for those working groups or sub-boards).

**5.33.16 Allowances/Expenses** – The terms should specify the policy in relation to the payment of allowances and expenses to Board members (see section 9 of this guidance).

**5.33.17 Budget** – The terms of reference should also set out a process for the Local Pension Board to have access to a budget for specified purposes, for example seeking professional advice, training for members, accommodation costs or meeting the costs of any claim for expenses.

**5.33.18 Knowledge and Understanding** – The terms should refer to the requirement for the Board to have a policy and framework to meet the knowledge and understanding requirements of the 2004 Act (see section 6 of this guidance).

**5.33.19 Reporting** – The terms should include arrangements for the reporting of information to the Administering Authority, including direct reporting arrangements where the Board has material concerns (see section 8 of this guidance).

**5.33.20 Data Protection** – The terms should take account of the Administering Authority's role as a 'data controller' under data protection legislation and any policies, such as a data protection policy, with which it must comply (as well as ensuring personal data processing by the Local Pension Board is within the Administering Authority's notification registered with the Information Commissioner from time to time (which should be reviewed and updated as necessary) – see paragraphs 8.15 to 8.19 for further details).

**5.34** The terms of reference should be approved by the Administering Authority. The terms of reference should also be formally adopted by the Local Pension Board once it is established. This would normally be expected to occur at the Board's first meeting.



## **Other Constitutional Documents**

5.35 In addition to the terms of reference a Board is likely to have other key documents which would be included in its wider constitution. These may include:

5.35.1 A code of conduct (see paragraphs 7.9 to 7.11);

5.35.2 A conflicts policy (see paragraphs 7.40 to 7.41);

5.35.3 A knowledge and understanding policy document (see paragraph 6.7) including a list of the core documents recording policy about the administration of the Fund; and

5.35.4 Policies dealing with data protection, information security, acceptable use (and monitoring) and subject access request (see paragraph 8.19).

## **Failure to Establish a Local Pension Board**

5.36 If an Administering Authority fails to establish its Local Pension Board by 1 April 2015, or having done so the Board fails to exercise its role, the question then arises as to what steps might be taken and by whom to challenge the action or lack of action of the Administering Authority. There are a number of potential possibilities:

5.36.1 Intervention by the Regulator.

5.36.2 Intervention by legal action - In principle an action by way of judicial review could be launched to ensure compliance where there has been failure to comply with a statutory obligation. It will be necessary to consider who might have interest or standing to bring such an action. Potentially this could be a body or person who has been denied representation by the failure to establish the Local Pension Board.

5.36.3 Complaint to the Local Government Ombudsman or Pensions Ombudsman. A failure by the Administering Authority to establish a Local Pension Board is likely to constitute maladministration on the part of the Administering Authority.

5.36.4 Adverse comment by the Administering Authority's district auditor in the context of the annual audit and management letter and/or by the Administering Authority's auditor.

5.36.5 Adverse comment by the Scheme Advisory Board.

5.36.6 the Secretary of State overarching responsibility for the Scheme as the Responsible Body - with a clear interest in the successful implementation of local pension boards.

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## **6. Board Knowledge and Understanding**

### **Legal requirements**

6.1 In accordance with section 248A of the 2004 Act, every individual who is a member of a Local Pension Board must:

6.1.1 be conversant with:

6.1.1.1 the rules of the LGPS, in other words the Regulations and other regulations governing the LGPS (such as the Transitional Regulations and the Investment Regulations); and

6.1.1.2 any document recording policy about the administration of the Fund which is for the time being adopted in relation to the Fund, and

6.1.2 have knowledge and understanding of:

6.1.2.1 the law relating to pensions; and

6.1.2.2 such other matters as may be prescribed.

6.2 A Local Pension Board member should be aware that their legal responsibilities begin from the date they take up their role on the Board and so should immediately start to familiarise themselves with the documents as referred to in paragraph 6.1.1 and the law relating to pensions. Administering Authorities should however recognise that newly appointed members will need additional support and training in the first few months, to help them reach the appropriate level of knowledge and understanding.

6.3 In accordance with section 248A, the knowledge and understanding requirement applies to every individual member of a Local Pension Board rather than to the members of a Local Pension Board as a collective group.

### **General Principles**

6.4 Administering Authorities should also take account of this Guidance to support them in understanding the requirement and to enable them to help members of the Local Pension Board to meet their knowledge and understanding obligations.

- 6.5 Knowledge and understanding must be considered in light of the role of a Local Pension Board to assist the Administering Authority in line with the requirements set out at paragraph 3.27.
- 6.6 However, members of a Local Pension Board clearly need to understand the duties and obligations of the Administering Authority, including funding and investment matters, in order to be able to assist it.
- 6.7 Once created, a Local Pension Board should establish and maintain a policy and framework to address the knowledge and understanding requirements that apply to its members. Where the Pensions Committee has an existing knowledge and understanding policy already in place, it may be sensible to see if this could be incorporated to cover both the Pensions Committee and the Local Pension Board to avoid unnecessary duplication. However the knowledge and understanding requirements of a Local Pension Board and a Pension Committee may differ, especially given the former's statutory requirements.
- 6.8 The Local Pension Board may wish to designate a person to take responsibility for ensuring that the knowledge and understanding framework is developed and implemented. This could be a member of the Local Pension Board or an external person, for example an officer of the Administering Authority or a professional adviser.

### **Knowledge and Understanding for Pension Committee Members**

- 6.9 The legal requirement for knowledge and understanding for members of a Local Pension Board does not apply to members of a Pension Committee. However, the requirement serves as a useful benchmark for the knowledge and understanding that a member of a decision-making Pension Committee should have.

### **The Regulator's Code of Practice**

- 6.10 The issue of knowledge and understanding is dealt with in the Regulator's Code of Practice (see paragraphs 32 to 56). This Guidance is intended to reflect the principles of the Code of Practice and apply them in a LGPS context.

### **Degree of Knowledge and Understanding**

- 6.11 Being conversant with the rules of the LGPS and any document recording policy about the administration of the Fund means having a working

knowledge (i.e. a sufficient level of familiarity) of them so that members of a Local Pension Board can use them effectively when carrying out their role of assisting the Administering Authority.

- 6.12 In particular members of a Local Pension Board should understand the rules and documents in enough detail to know where they are relevant to an issue and where a particular provision or policy may apply.
- 6.13 In order to assist the Administering Authority, it is implicit that members of a Local Pension Board understand the duties and obligations that apply to the Administering Authority as well as to themselves.
- 6.14 The rules of the LGPS would include:
  - 6.14.1 The Regulations;
  - 6.14.2 The Investment Regulations; and
  - 6.14.3 the Transitional Regulations (including any Earlier Regulations as defined in the Transitional Regulations to the extent they remain applicable),and any statutory guidance referred to in these regulations.
- 6.15 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 sure that the list and documents (as well as the rules of the LGPS) are accessible to its members.
- 6.16 Part 1 of Schedule A of this Guidance contains a list of some documents which are likely to be regarded as recording policy about the administration of a Fund. This list should not be relied upon as being definitive and actual lists are likely to vary from Fund to Fund.
- 6.17 Members of a Local Pension Board should also be aware of the range and extent of overriding law which applies to the LGPS and have sufficient knowledge and understanding of the content and effect of that law to recognise when and how it impacts on their responsibilities.
- 6.18 Part 2 of Schedule A of this Guidance contains a summary of some of the key areas of law relating to pensions generally and the LGPS in particular. This summary should not be relied upon as being definitive list of all the areas of law that members of a Local Pension Board need to know about and understand.

- 6.19 Given the role of the Local Pension Board to assist the Administering Authority, members of a Local Pension Board should have sufficient knowledge and understanding to challenge any failure by the Administering Authority to comply with the Regulations and other legislation relating to the governance and administration of the LGPS and/or any failure to meet the standards and expectations set out the Code of Practice.
- 6.20 Members of a Local Pension Board should have a breadth of knowledge and understanding that is sufficient to allow them to understand fully any professional advice they are given. Members should be able to challenge any information or advice they are given and understand how that information or advice impacts on any decision relating to their duty to assist the Administering Authority.

### **Acquiring, Reviewing and Updating Knowledge and Understanding**

- 6.21 A Local Pension Board's knowledge and understanding policy and framework should provide for the acquisition and retention of knowledge and understanding for its members.
- 6.22 Members of the Local Pension Board should commit sufficient time in their learning and development alongside their other duties. 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.
- 6.23 Members of the Local Pension Board must be aware that their knowledge and understanding responsibilities technically begin from the date they take up their post. Therefore, members should immediately start to familiarise themselves with the LGPS regulations, key Fund documents and relevant pensions law.
- 6.24 The Administering Authority should provide (or at least ensure Local Pension Board members have access to) high quality induction (and ongoing) training. This could be included in the normal training programme for members of the Pensions Committee as well as a specific training programme for the Local Pension Board.
- 6.25 It may also be useful for the Local Pension Board to have shared training events with the Pensions Committee and/ or Pension Committees and Local Pension Boards from other Funds to share knowledge and experience.

- 6.26 Given the level of knowledge and understanding that members of a Local Pension Board need to gain, newly appointed members are likely to need additional support and training in the first few months of their appointment in order to competently carry out their responsibilities. There must be a practical recognition that it will take a newly appointed member a reasonable period to attain the required full level of knowledge and understanding (see paragraph 6.2).
- 6.27 A Local Pension Board's knowledge and understanding policy and framework should require its members to undertake a personal training needs analysis and regularly review their skills, competencies and knowledge to identify gaps or weaknesses.
- 6.28 Part 2 of Schedule A contains examples of areas of knowledge and understanding that a member of a Local Pension Board might be expected to have. These examples may assist a member in undertaking a personal training needs analysis.
- 6.29 A personalised training plan should then be used to document and address these promptly. This would be supported by any person the Local Pension Board has designated to implement the framework.
- 6.30 Learning programmes should be flexible, allowing members of the Local Pension Board to access specific modules, when necessary or relevant. This will enable them to update particular areas of learning where required and acquire new areas of knowledge in the event of any change. For example, members of the Local Pension Board who take on new responsibilities in their role will need to have knowledge and understanding which is relevant to carry out those new responsibilities.
- 6.31 The Regulator will be providing an e-learning programme which has been developed to meet the needs of all members of public sector scheme pension boards, whether or not they have access to other learning. Members of a Local Pension Board should also investigate what other third party learning tools and courses may be available.
- 6.32 Once a Local Pension Board is in operation and new appointments are made in the future, mentoring by existing members could also be considered. This can also help to ensure that historical and scheme specific knowledge is retained when members of a Local Pension Board change.

## **Demonstrating Knowledge and Understanding**

- 6.33 The Local Pension Board should keep appropriate records of the learning activities of individual members and the Local Pension Board as a whole. This will assist members in demonstrating their compliance, if necessary, with the legal requirement and how they have mitigated risks associated with knowledge gaps. For example 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.
- 6.34 Members of the Local Pension Board who are appointed for their specific expertise and skills should be able to demonstrate to the Administering Authority and to their fellow Local Pension Board members that they have the appropriate knowledge and understanding, including any relevant qualifications, from the date of their appointment to the Local Pension Board.

### **Action Points:**

- Once established a Local Pension Board should adopt a knowledge and understanding policy and framework (possibly in conjunction with the Pensions Committee if appropriate).
- 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.
- The Administering Authority should provide access to high quality induction (and ongoing) training to the appointed members of its the Local Pension Board.
- 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.
- Members of a Local Pension Board should undertake a personal training needs analysis and put in place a personalised training plan.



## **7. Conduct of Members and Conflicts of Interest**

### **Introduction**

- 7.1 There are various legal requirements which need to be considered to make sure that sound governance principles are followed, and in particular that conflicts of interest are properly managed. These include:
- 7.1.1 Section 5(5) of the 2013 Act, which defines “conflict of interest” for the purpose of a Local Pension Board;
  - 7.1.2 Regulation 108 of the Regulations, which places duties on the Administering Authority to satisfy itself that Local Pension Board members do not have conflicts of interest on appointment or whilst they are members of the Board;
  - 7.1.3 The 2011 Act, which requires councillors to comply with the code of conduct of their local authority and to disclose interests;
  - 7.1.4 The ‘Nolan Principles’, with which any holder of public office is also expected to comply; and
  - 7.1.5 The expectations contained in the Regulator’s Code of Practice.
- 7.2 This section of the Guidance takes accounts of the above requirements and gives guidance on how the different duties can be reconciled in a practical way.
- 7.3 The importance of following these requirements needs to be clearly appreciated at the outset. Failure to follow applicable codes of conduct or declare a conflict of interest can impact on good governance in various ways. For example, such failure may result in a Local Pension Board actually acting improperly, may lead to a perception that the Local Pension Board has acted improperly, or may result in a challenge to the work carried out by the Board.

### **Codes of Conduct and Disclosure of Interests for Councillors**

- 7.4 The elected and co-opted members of a local authority (referred to as “councillors” for the purposes of this section of the Guidance) are governed by their local authority’s code of conduct for councillors. This code is required of every local authority by the 2011 Act and sets out the standards of behaviour expected of individuals in their capacity as councillors.

- 7.5 In addition, there is a legal obligation for councillors to disclose, in a register maintained by the authority's monitoring officer, certain pecuniary interests, as defined in regulations made under the 2011 Act.
- 7.6 Both of these requirements will apply to any members of a Local Pension Board who are also councillors of a local authority (whether that is the Administering Authority or another local authority). They will not apply to members of a Local Pension Board who are not councillors.

### **Seven Principles of Public Life**

- 7.7 The members of a Local Pension Board should have regard to the 'Seven Principles of Public Life' (known as the Nolan Principles), which are:
- 7.7.1 **Selflessness** - Holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other benefits for themselves, their family or their friends.
  - 7.7.2 **Integrity** - Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might seek to influence them in the performance of their official duties.
  - 7.7.3 **Objectivity** - In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.
  - 7.7.4 **Accountability** - Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.
  - 7.7.5 **Openness** - Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands it.
  - 7.7.6 **Honesty** - Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.

**7.7.7 Leadership** - Holders of public office should promote and support these principles by leadership and example.

7.8 As members of a publicly-funded body involved in the discharge of public business, all members of a Local Pension Board should comply with these principles in the exercise of their functions. They require the highest standards of conduct.

### **Code of Conduct for Local Pension Boards**

7.9 When establishing its Local Pension Board, the Administering Authority should prepare and approve a code of conduct for the Board to adopt. The code of conduct should set out the standards of behaviour expected of members, incorporating the Seven Principles. An Administering Authority may wish to effectively adopt some or all of an existing Code of Conduct for the Local Pension Board. Once adopted, the Local Pension Board should keep this code of conduct under regular review.

7.10 The code of conduct should also make reference to the need for members of the Local Pension Board who are councillors to comply with any separate code of conduct and disclosure requirements which apply to them in their capacity as councillors (in other words, the Local Pension Board's code should make it clear that it is not an exhaustive statement of the standards of behaviour required of Board members).

7.11 It is important that individual members of the Local Pension Board are familiar with and understand the importance of following the principles in the Board's code of conduct, and the Board should arrange appropriate training for members on this issue.

### **Conflicts of Interest – General Comments**

7.12 As an introductory point, although there is a requirement for Local Pension Board members not to have a conflict of interest, it is important to note that the issue of conflicts of interest must be considered in light of the Local Pension Board's role, which is to assist the Administering Authority. The Local Pension Board does not make decisions in relation to the administration and management of the Fund: these rest with the Administering Authority. As a result, it is not anticipated that significant conflicts will arise in the same way as would be the case if the Board were making decisions on a regular basis (compared, for example, to a Pensions

Committee). Nevertheless, steps need to be taken to identify, monitor and manage conflicts effectively.

### **The Regulator's Code of Practice on Conflicts of Interest**

- 7.13 The Regulator has a particular role in relation to members of a Local Pension Board and conflicts of interest. Whilst members of a Local Pension Board may be subject to other legal requirements, when exercising functions as a member of a Local Pension Board, the Regulator expects the requirements which specifically apply by virtue of the 2013 Act to be met and the standards of conduct and practice set out in its Code of Practice to be complied with.
- 7.14 The Code of Practice offers guidance about managing potential conflicts and the identification, monitoring and management of actual conflicts. This Guidance is intended to reflect the principles of the Regulator's Code of Practice and apply them in a LGPS context.

### **What is a Conflict of Interest?**

- 7.15 For the purposes of a member of a Local Pension Board, a 'conflict of interest' is defined in section 5(5) of the 2013 Act as a financial or other interest which is likely to prejudice a person's exercise of functions as a member of a Local Pension Board.
- 7.16 The 2013 Act also specifies that a conflict does not include a financial or other interest arising merely by virtue of that person being a member of the LGPS and/or Fund (or any connected scheme).
- 7.17 Therefore, a conflict of interest may arise when a member of a Local Pension Board:
- 7.17.1 must fulfil their legal duty to assist the Administering Authority;  
and
  - 7.17.2 at the same time they have:
    - 7.17.2.1 a separate personal interest (financial or otherwise); or
    - 7.17.2.2 another responsibility in relation to that matter,  
giving rise to a possible conflict with their first responsibility as a Local Pension Board member.

## **Examples of Conflicts of Interest**

7.18 Some examples of potential conflicts in this context would include:

7.18.1 A finance officer appointed as a member of a Local Pension Board may, from time to time, be required to take or scrutinise a decision which may be, or appear to be, in opposition to another interest or responsibility. For example, they may be required as a member of the Local Pension Board to take or scrutinise a decision which involves the use of departmental resources to improve scheme administration, whilst at the same time being tasked, by virtue of their employment, with reducing departmental spending.

7.18.2 A member representative who works in the Administering Authority's internal audit department may be required as part of his work to audit the Fund. For example, the employee may become aware of confidential breaches of law by the Fund which have not yet been brought to the attention of the Local Pension Board.

7.18.3 An employer representative from the private sector may also have a conflict of interest as a decision-maker in their own workplace. For example, if an employer representative is drawn from a company to which the Administering Authority has outsourced its pension administration services and the Board are reviewing the standards provided by it.

## **Identifying, Monitoring and Managing Conflicts – The Role of the Administering Authority**

7.19 The Regulations place a duty on the Administering Authority to satisfy itself that those appointed to its Local Pension Board do not have an actual conflict of interest prior to appointment and “from time to time”.

7.20 There is a corresponding duty on any person who is proposed to be appointed to a Local Pension Board, and on an appointed member of a Local Pension Board, to provide the Administering Authority with such information as the Administering Authority reasonably requires to satisfy itself that such person has no conflicts of interest.

7.21 To comply with its duty in relation to conflicts, the Administering Authority needs to put procedures in place in respect of appointment of members and

establish policies to be included in the Board's constitution to ensure that interests are declared, potential conflicts are identified and members of the Board are trained and receive advice on conflicts.

- 7.22 Looking first at the process of appointments, the Administering Authority should ensure that members of a Local Pension Board are appointed under procedures that require them to disclose any dual interests or responsibilities, which could become conflicts of interest and which may adversely affect their suitability for the role, before they are appointed. The appointment process should facilitate scrutiny of potential areas of difficulty by eliciting relevant information. The fact an individual could potentially have a conflict of interest at some point in the future should not preclude an individual being appointed provided he or she does not have an actual conflict of interest when appointed.
- 7.23 All terms of engagement (for example, appointment letters and any contracts for services) should include a clause requiring disclosure of all dual interests and responsibilities which have the potential to become conflicts of interest, as soon as they arise. All interests and responsibilities disclosed should be recorded.
- 7.24 As regards the Administering Authority's ongoing obligation to ensure that members of the Local Pension Board do not have a conflict of interest, the Administering Authority will need to keep appointments under review and also monitor whether appointed members have potential conflicts of interest and are declaring them appropriately. This could be achieved by requesting reports from the Local Pension Board, perhaps annually.

### **Identifying, Monitoring and Managing Conflicts – The Role of the Local Pension Board**

- 7.25 Local Pension Boards should cultivate a culture of openness and transparency. The need for continual consideration of conflicts should be recognised. Disclosure of dual interests and responsibilities, which have the potential to become conflicts of interest, should not be ignored.
- 7.26 The Local Pension Board should ensure that its members have a clear understanding of their role and the circumstances in which they may find themselves in a position of conflict of interest, and should know how potential conflicts should be managed. Many Local Pension Board members are likely to be familiar with the concept of a conflict of interests

and it should not be difficult to adapt established procedures to meet the obligations in the 2013 Act and the Regulations.

- 7.27 Local Pension Boards should identify, monitor and manage dual interests and responsibilities which are or have the potential to become conflicts of interest.
- 7.28 Local Pension Boards should evaluate the nature of any dual interests and responsibilities and assess the impact on their operations and good governance were a conflict of interest to materialise.
- 7.29 When seeking to prevent a potential conflict of interest becoming detrimental to the conduct or decisions of a Local Pension Board, the Board should consider obtaining professional legal advice when assessing any option.
- 7.30 A register of interests should provide a simple and effective means of recording and monitoring dual interests and responsibilities.
- 7.31 Local Pension Boards should also capture decisions about how any identified potential conflicts of interest should be managed – ideally, in their register of interests.
- 7.32 Options for managing an actual conflict of interest, should one arise, include:
  - 7.32.1 A member withdrawing from the discussion and any decision-making process;
  - 7.32.2 The Board establishing a sub-board to review the issue (where the terms of reference give the power to do so); or
  - 7.32.3 A member resigning from the Board if the conflict is so fundamental that it cannot be managed in any other way.
- 7.33 The Local Pension Board's register of interests should be circulated to the Local Pension Board for ongoing review and should be published (for example, on the Fund's website). The Local Pension Board should report any concerns to the Administering Authority and include in an annual report a section on good governance and management of conflicts.
- 7.34 Conflicts of interest should be included as an opening agenda item at Local Pension Board meetings, and revisited during the meeting where necessary. This provides an opportunity for those present, including non-



Board members, to declare any dual interests and responsibilities, which have the potential to become conflicts of interest, and to minute discussions about how they will be managed so as to prevent an actual conflict arising.

- 7.35 Local Pension Boards should take time to consider what key decisions are likely to be made during, for example, the year ahead and identify and consider any conflicts of interest that may arise in respect of these future decisions.

### **Considering Conflicts of Interest – Responsibilities of Board Members**

- 7.36 It is important that individual members of the Local Pension Board know how to identify when they have a conflict of interest which needs to be declared and which may also restrict their ability to participate in meetings or decision-making. They also need to appreciate that they have a legal duty under the Regulations to provide information to the Administering Authority in respect of conflicts of interest.
- 7.37 Individual Local Pension Board members should seek professional advice from a nominated officer (for example, the monitoring officer) or external advisers where necessary and the importance of doing so should be emphasised in the Local Pension Board's conflicts policy.

### **Managing Adviser and Officer Conflicts**

- 7.38 A Local Pension Board may need to seek specialist advice or support, for example legal advice. The Board may use an officer of the Administering Authority or a third party adviser. However, in both cases the Board should be confident that such advice is independent and any potential or actual conflicts are disclosed by the officer or adviser on a timely basis to the Board. For example, an adviser may have a conflict of interest if he or she (or the same firm) is also advising the Administering Authority.
- 7.39 The risk to the Local Pension Board is that the adviser does not provide, or is not seen to provide, independent advice. Where there is likely to be a conflict of interest in giving advice, the Board should consider carefully whether it is appropriate to appoint the adviser in the first place. It may also be necessary to consider carefully whether they should take steps to remove an adviser who has already been appointed.



## **Conflicts Policy**

- 7.40 When establishing its Local Pension Board, the Administering Authority should prepare and approve a conflicts policy for the Board to adopt. The conflicts policy should cover the points discussed in the preceding paragraphs relating to the identification, monitoring and management of potential conflicts of interest (including adviser conflicts). Once adopted, the Local Pension Board should keep this policy under regular review.
- 7.41 The conflicts policy should include as a minimum:
- 7.41.1 examples of scenarios giving rise to conflicts of interest (which may include those set out at paragraph 7.18 above);
  - 7.41.2 how a conflict might arise specifically in relation to a member of a Local Pension Board; and
  - 7.41.3 the process to be followed by members of a Local Pension Board and the Administering Authority to address a situation where members are subject to a potential or actual conflict of interest.

### **Action Points:**

- 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.
- Training should be arranged for officers and members of a Local Pension Board on conduct and conflicts.
- A Local Pension Board should establish and maintain a register of interests for its members.

## **8. Reporting**

### **Internal Reporting**

- 8.1 Each Administering Authority has the prime responsibility for establishing its Local Pension Board and it is therefore appropriate and consistent with good governance for the Local Pension Board to report to the Administering Authority.
- 8.2 The reporting requirements will be for each Administering Authority to determine and could include reporting and communicating with a range of individuals and decision making bodies. This could include communication with internal and external audit as well as reporting to the audit committee, scrutiny or a corporate resources committee, as well as full council or equivalent where appropriate. The agreed reporting requirements should be reflected in the Local Pension Board's terms of reference.
- 8.3 There should also be more frequent reporting (perhaps quarterly or after the Local Pension Board meets) to the Administering Authority/Pension Committee and the chief finance officer and/or monitoring officer for example, this could be achieved through sharing the minutes of Board meetings in a timely manner.
- 8.4 The Local Pension Board should take responsibility in conjunction with the Administering Authority for ensuring the necessary reports are prepared and delivered.
- 8.5 A report to full council (or equivalent) or another committee/officer the Administering Authority has delegated to receive it, could include:
  - 8.5.1 a summary of the work of the Local Pension Board;
  - 8.5.2 details of areas reported to the Board to be investigated by the Local Pension Board and how they have been dealt with;
  - 8.5.3 details of any conflicts of interest that have arisen in respect of individual Local Pension Board members and how these have been managed;
  - 8.5.4 whether there are any risks or other areas of potential concern which the Board wishes to raise with the Administering Authority (although legal advice to the Local Pension Board should not be shared with a full council meeting and nor should a summary of

it, since once legal advice goes beyond the intended 'client' and / or confidentiality is lost, privilege will be waived and this would also have an impact on the availability of the FOIA exemption for legally privileged information);

8.5.5 details of training received and future training needs;

8.5.6 the work plan for the last year and a draft of the work plan for the following year; and

8.5.7 details of any expenses and other costs incurred by the Local Pension Board and anticipated expenses for the forthcoming financial year. These costs will be met as part of the administration costs of the Fund.

8.6 The above topics should also form the basis of ongoing regular reports to the Administering Authority/Pension Committee who should be asked to comment on the draft work plan, for views on how complaints and risks reported to the Board have been managed and confirm that the Local Pension Board is acting within its terms of reference and in accordance with good governance principles.

#### **Escalation by the Local Pension Board of more serious concerns**

8.7 The terms of reference for the Local Pension Board should include procedures for the Local Pension Board to report concerns which are sufficiently serious to be reported directly at a higher level, or where a concern has been raised with the Pension Committee and the Local Pension Board consider the Pension Committee have not taken appropriate action to rectify the issue (or appropriate action within a reasonable time period). Such concerns may include a fundamental breach of the Regulations or a fundamental failure by the Administering Authority to ensure the effective governance of the Fund.

8.8 The terms of reference would need to identify who such concerns are reported to. This could be to named officer(s), a sub-committee or Council (or equivalent), or combination of these to avoid issues having to be reported immediately to full Council.

8.9 Escalation via the Scheme Advisory Board or the Responsible Authority where internal channels are not appropriate may also be an option used by the Local Pension Board. In addition it may be appropriate to report serious concerns to the Regulator.

### **Internal Reporting - Conflicts of interest**

- 8.10 All members of the Local Pension Board must provide the Administering Authority with such information it reasonably requires for the purposes of satisfying itself that none of the members of the Local Pension Board has a conflict of interest. This is considered in more detail in section 7 of this guidance.

### **Internal Reporting - Record-keeping**

- 8.11 Where the Local Pension Board is established as a local authority committee with the Secretary of States consent, in accordance with regulation 106(2) of the Regulations, the usual provisions about transparency in respect of access to information and reports will apply. In that case, the terms of reference for the Local Pension Board should include provisions dealing with the provision of agendas and reports in advance of Local Pension Board meetings and making those publically available (with the exception of confidential or personal information).
- 8.12 Where the Local Pension Board is established as a Board in its own right, as is more likely, there is no requirement to make reports and minutes available and the Administering Authority will need to decide whether or not it wishes to make agendas, reports and minutes available to the public (and indeed whether it would permit someone who is not a member of the Local Pension Board to attend a meeting). If a decision is made to allow some or all papers to be available that must be with the exception of confidential or personal information.
- 8.13 Minutes of meetings should also be available and published in accordance with procedures for other meetings, for example on the website of the Administering Authority.
- 8.14 All papers and records should be prepared to minimise personal data, to separate all general confidential information and should be drafted wherever possible as if they may be made public (whether directly or, if received by the Administering Authority, through them).

### **Data Protection**

- 8.15 For legal purposes a Local Pension Board is considered a committee of and part of the Administering Authority legal entity. The Administering Authority is and remains the data controller responsible for DPA compliance, including for processing carried out by the Local Pension Board, where processing is

carried out as a data controller, or where personal data use by the Local Pension Board is not carried out for and on behalf of any other separate legal entity.

8.16 Since the Local Pension Board is not a separate legal entity processing personal data, it cannot be a data controller itself under the DPA (even to the extent that the Local Pension Board independently uses personal data of its Board members, processes information about its relationships with other individuals and scrutinises records containing personal data of Fund members from the Administering Authority).

8.17 The Administering Authority must already comply with DPA data protection principles and must (amongst other requirements):

8.17.1 **Notification** – notify the DPA regulator, the Information Commissioner's Office ("ICO"), of all of the purposes for which they may be using personal data (including Local Pension Board purposes) and renew this annually (unless exempt).

8.17.2 **Fair and lawful processing** – provide privacy notices to individuals whose personal data is processed (including by the Local Pension Board) in most but not all cases.

8.17.3 **Disclosures** – if using data processors (service providers using personal data on behalf of the Local Pension Board), have an appropriate written contract in place containing legally required and ICO recommended provisions to protect personal data.

8.17.4 **Transfers** – not directly or indirectly 'export' personal data to a country outside the European Economic Area and European Commission's 'white list' countries unless "adequate safeguards" have been put in place (such as entering into a data transfer agreement on the basis of the EU Commission's model clauses).

8.18 To better comply with the ICO's expectations and evidence compliance with data protection principles, it is recommended that (to the extent not yet done) the Administering Authority implement additional measures (also covering their Local Pension Board and their staff and operations), including:

8.18.1 adopting policies such as a data protection policy, information security policy, acceptable use (and monitoring) policy and subject access request policy; and

- 8.18.2 training on key DPA issues, requirements and policy compliance. This should form part of the knowledge and understanding requirements (see paragraph 6.1).
- 8.19 Given that the Local Pension Board is not considered a separate legal entity, the Administering Authority remains the responsible data controller. Accordingly:
- 8.19.1 The Administering Authority's notification registered with the Information Commissioner should be reviewed and, if necessary amended to cover proposed personal data processing by the Local Pension Board (failure to have a current up to date notification being a criminal offence);
- 8.19.2 The Local Pension Board and Administering Authority should liaise to understand the Authority's requirements and controls and policies for data protection compliance so that the Local Pension Board is aware of them and can comply with them (avoiding duplication and inconsistency of approach) and where necessary so that appropriate changes can be made to such requirements, controls and policies before adoption and implementation by the Local Pension Board;
- 8.19.3 The Local Pension Board and Administering Authority should be able to discuss and agree appropriate procedures for dealing with material data protection compliance issues, such as a potential security breach.

### **Freedom of Information**

- 8.20 To be bound by the FOIA a body must be a FOIA public authority. Administering Authorities are already FOIA public authorities.
- 8.21 Local Pension Boards are not legal entities in their own right and so cannot be FOIA public authorities in their own right (and do not meet any of the FOIA public authority criteria as a Local Pension Board at present). However, Local Pension Boards will be part of that same legal entity as the Administering Authority, and so the Local Pension Board will already be part of that FOIA public authority. Accordingly, information records created or obtained by the Local Pension Board will be accessible from it, or any part of its Administering Authority under FOIA. The Local Pension Board must liaise with the Administering Authority to:

- 8.21.1 understand the Authority's requirements and controls and policies for FOIA compliance so that the Local Pension Board is aware of them and can comply with them (avoiding duplication and inconsistency of approach) and, where necessary so that appropriate changes can be made to such requirements, controls and policies before adoption and implementation by the Local Pension Board;
- 8.21.2 Agree what details are made available through the Administering Authority's publication scheme and so that it can be updated as necessary;
- 8.21.3 Agree what procedure applies in relation to FOIA information requests received by the Local Pension Board and / or received by the Administering Authority about the Local Pension Board to ensure proper and consistent consultation, action and response within applicable time limits.

#### **External Reporting - Breaches of Law**

- 8.22 In accordance with section 70 of the 2004 Act, certain individuals must report to the Regulator as soon as reasonably practicable where that individual has reasonable cause to believe that:
  - 8.22.1 a duty which is relevant to the administration of the LGPS, and is imposed by or by virtue of an enactment or rule of law, has not been or is not being complied with; and
  - 8.22.2 the failure to comply is likely to be of material significance to the Regulator in the exercise of any of its functions.
- 8.23 This obligation directly applies to each individual who is a member of the Local Pension Board. In addition, it also extends to the Administering Authority, participating employers in the LGPS, any person who is otherwise involved in the administration of the LGPS, any person who is otherwise involved in advising the Administering Authority and, in some circumstances, professional advisors of the Administering Authority.

#### **Implementing adequate arrangements**

- 8.24 The Local Pension Board should have effective arrangements in place to meet its duty to report breaches of law. Please refer to paragraphs 234 to 235 of the Code of Practice as to the procedures that should be established



and operated to ensure that members of the Local Pension Board are able to meet their legal obligations.

### **Judging whether a breach must be reported**

8.25 The decision whether to report requires two key judgments:

8.25.1 Is there reasonable cause to believe there has been a breach of law?

8.25.2 If so, is the breach likely to be of material significance to the Regulator?

8.26 Paragraphs 237 to 251 of the Code of Practice provides guidance as to what is meant by 'reasonable cause' and how to judge whether a breach is likely to be of 'material significance' to the Regulator.

### **Submitting a report to the Regulator**

8.27 Reports must be submitted in writing. Paragraphs 251 to 259 of the Code of Practice specifies how and the format in which a report should be submitted.

8.28 The requirement to report applies to all those subject to the reporting duty who become aware of a breach that is likely to be of material significance to the Regulator; it is not automatically discharged by another party reporting the breach. However, in practice, where the Local Pension Board considers there has been a breach it may be appropriate to inform and review this with the Administering Authority and (where appropriate) the Fund advisor(s) so that a collective report can be submitted. An exception to this arrangement will apply in cases where there is a suspicion or dishonesty or other serious wrongdoing by the Administering Authority and/or the Fund advisor(s).

### **Non-compliance**

8.29 Failure to comply with the obligation imposed to report breaches of law without 'reasonable excuse' is a civil offence under section 10 of the Pensions Act 1995. An individual member of a Local Pension Board could be fined up to £5,000.

### **External Reporting - Annual Report**

8.30 It would be good practice for the Local Pension Board to consider publishing an annual report of the Local Pension Board's activities for that year for circulation to Fund to employers and members.



- 8.31 The Local Pension Board should consider with the Administering Authority whether it would be appropriate to detail these activities as part of the Fund's annual report or to publish its own separate report.

### **External Reporting - Governance Compliance Statement**

- 8.32 Section 6 of the 2013 Act requires a scheme manager to publish information about its pension board.
- 8.33 In terms of the LGPS, this requirement is dealt with under regulation 55 of the Regulations which requires the Administering Authority to include within its governance compliance statement details of the terms, structure and operational procedures relating to its Local Pension Board.
- 8.34 Current governance compliance statements will need to be revised to include this new information. The Administering Authority will firstly need to consult with such persons as it thinks necessary about the revised statement and then publish it once it has been revised.

### **External Reporting - The Regulator**

- 8.35 If the Regulator has reasonable grounds to suspect or believe that a member of a Local Pension Board:

8.35.1 has misappropriated any assets of the Fund or is likely to do so;  
or

8.35.2 has a conflict of interest in relation to the investment of assets of the Fund,

the Regulator must report the matter to the Administering Authority. However, given that a Board member should not have access to Fund assets or be involved in the investment of Fund assets then the exercise of this duty should be rare in practice.

### **Action Points:**

- An Administering Authority should agree the ongoing reporting arrangements between the Local Pension Board and the Administering Authority.
- 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.

- A Local Pension Board should put in place arrangements to meet the duty of its members to report breaches of law.
- A Local Pension Board should consider (with its Administering Authority) the need to publish an annual report of its activities.
- 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.

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## **9. Resourcing and Funding**

### **Resourcing of Local Pension Boards**

- 9.1 It is appropriate that a Local Pension Board is given adequate resources to fulfil its task, in the same way that statutory officers of the Administering Authority and scrutiny committees are entitled.
- 9.2 As a minimum, the Board will require:
- 9.2.1 Allowances and expenses for Board members;
  - 9.2.2 Accommodation and administrative support to conduct its meetings and other business;
  - 9.2.3 Training; and
  - 9.2.4 Legal, technical and other professional advice.
- 9.3 Given the role of a Local Pension Board to assist the Administering Authority to secure compliance with legal and regulatory matters and to ensure the effective and efficient governance and administration of the LGPS, the need for the Local Pension Board to seek its own legal, technical and other professional advice cannot be discounted.

### **Funding of Local Pension Boards**

- 9.4 Regulation 106(7) of the Regulations specifies that the expenses of a Local Pension Board shall be regarded as part of the costs of administration of the Fund.
- 9.5 These expenses will include (but are not limited to) the cost of secretarial support and any necessary advisory support, overheads attaching to the arranging of meetings and, if the Administering Authority makes provision, payment of allowances and/or expenses to members of the Local Pension Board (see paragraph 5.33.16).
- 9.6 The Administering Authority will also need to give early consideration to how the arrangements for meeting the Local Pension Board's expenditure will be administered. The options include:
- 9.6.1 allocating a budget which is managed by the Local Pension Board; or

- 9.6.2 requiring the Local Pension Board to seek approval from the Administering Authority for expenditure.
- 9.7 Given the statutory responsibilities of the Local Pension Board and its relationship with the Administering Authority, it will be a matter for early consideration by the Local Pension Board as to compiling its budget.
- 9.8 Consideration should be given by the Administering Authority to whether or not members of the Local Pension Board are paid allowances or reimbursed expenses. One option would be to set levels of allowance in a similar way to the elected members allowances scheme, perhaps with regard to allowances for co-opted members, and in accordance with established processes for declaring allowances which have been received in an open and transparent way. In deciding whether to award an allowance, and if so how much, the Administering Authority may wish to consider some or all of the following matters:
- whether the Board members are carrying out duties (including preparation and/or training) during personal time or whether it is during a period of authorised paid absence,
  - whether a Board member who has taken on the role of Chair is carrying out a range of additional responsibilities that merit additional payment,
  - whether an annual or per meeting allowance is more appropriate.

## **10. Other possible structures**

### **Combining a Local Pension Board and a Pension Committee**

- 10.1 Where an Administering Authority discharges its pensions functions through a committee, it can, with the approval of the Secretary of State, appoint the existing committee as the Local Pension Board.
- 10.2 Where an Administering Authority chooses to use an existing committee (subject to the approval of the Secretary of State) careful consideration will need to be given to the membership of the committee so that it complies with the requirement in regulation 107 of the Regulations to have equal numbers of employer and member representatives and to include at least two employer and two member representatives. The individuals appointed must have the capacity and experience to represent members and employers, as appropriate. Officers or members who have responsibilities for functions under the Regulations cannot be appointed. It is likely that the employee representatives will be co-opted members.
- 10.3 As well as complying with the Regulations, a Local Pension Board which is established as a local authority Pensions Committee will be subject to general requirements in the 1972 Act and the 1989 Act. We have summarised in Schedule B the key legal requirements which need to be considered where an authority wishes to seek approval from the Secretary of State to use an existing committee. This is a complex area and any authority intending to follow this route will need to take legal advice from their monitoring officer to make sure the plans comply with the different legal duties and their own Constitution.
- 10.4 At first sight it might seem attractive to combine the functions of a Local Pension Board and a Pension Committee to enable the Board to be included in existing decision making processes, including delegation to officers and publication of agendas and minutes. However, in practice it may be difficult to meet the requirements of the 1972 Act, the 1989 Act, the 2013 Act and the Regulations when combining a Local Pension Board and a local authority Pension Committee.
- 10.5 Firstly, if the Local Pension Board is to be a Pension Committee this can only be where written approval has been obtained from the Secretary of State.

- 10.6 Secretary of State approval may be given subject to such conditions as the Secretary of State thinks fit and equally may be withdrawn if such conditions are not met. The Secretary of State may also withdraw approval if in his or her opinion it is no longer appropriate for the Local Pension Board to be the Pension Committee.
- 10.7 Where an Administering Authority has delegated pension functions to more than one committee and it does not wish to create a separate Local Pension Board, it will be necessary to determine which of its committees is most appropriate to undertake the function of the Board.
- 10.8 It may also be necessary to review the membership of the existing Pension Committee as regulation 107 of the Regulations says that the Pension Board must consist of at least two employer and two member representatives.
- 10.9 If the Local Pension Board is to be a Pension Committee, it is difficult to see how the Local Pension Board can effectively and objectively fulfil its statutory function of assisting itself (as the Pensions Committee) to secure compliance with legal and regulatory matters and to ensure the effective and efficient governance and administration of the LGPS (which is the prime responsibility of the Pension Committee).

## 11. Other guidance

- The Pensions Regulator's Code of practice note 14 Governance and Administration of public service pension schemes.
- The Pensions Regulator's website:  
[www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)
- The Pensions Regulator's Pension Board member toolkit:  
<http://www.trusteetoolkit.com/arena/index.dfm>

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## SCHEDULE A

### PART 1

**Examples of documents recording policy about the administration of a Fund  
(please read in conjunction with paragraphs 6.16 and 6.17)**

1.	Member booklets, announcements and other key member and employer communications, which describe the Fund's policies and procedures (including any separate AVC guides) including documents available on the Fund's website	
2.	Any relevant policies of the Administering Authority and/or Pension Committee, for example policies on: <ul style="list-style-type: none"> <li>• conflicts of interests</li> <li>• record-keeping</li> <li>• data protection and freedom of information</li> <li>• internal dispute resolution procedure</li> <li>• reporting breaches</li> </ul>	
3.	The Administering Authority's governance compliance statement (as required by regulation 55 of the Regulations)	
4.	The Administering Authority's funding strategy statement (as required by regulation 58 of the Regulations)	
5.	The Administering Authority's pension administration statement (as required by regulation 59 of the Regulations)	
6.	The Administering Authority's discretionary policy statement (as required by regulation 60 of the Regulations)	
7.	The Administering Authority's communications policy statement (as required by regulation 61 of the Regulations)	
8.	The Administering Authority's statement of investment principles (as required by regulation 12 of the Investment Regulations)	



9.	The Administering Authority's internal controls risk register (for the purposes of section 249B of the 2013 Act)	
10.	The Fund's actuarial valuation report and rates and adjustment certificate (as required by regulation 62 of the Regulations)	
11.	The Fund's annual report and accounts (as required by regulation 57 of the Regulations) including any summary report (as required by regulation 56 of the Regulations)	
12.	Any accounting requirements relevant to the Fund	
13.	Any third party contracts and service level agreements	
14.	Any internal control report produced by third party service providers and investment managers	
15.	The Fund's standard form of admission agreement and bond and related policies and guidance	

## PART 2

**Examples of knowledge and understanding of the law relating to pensions  
(please read in conjunction with paragraphs 6.18 and 6.19)**

1.	<b>Background and Understanding of the Legislative Framework of the LGPS</b>	
	<ul style="list-style-type: none"> <li>• Differences between public service pension schemes like the LGPS and private sector trust-based schemes</li> <li>• Role of the IPSPC and its recommendations</li> <li>• Key provisions of the 2013 Act</li> <li>• The structure of the LGPS and the main bodies involved including the Responsible Authority, the Administering Authority, the Scheme Advisory Board, the Local Pension Board and the LGPS employers</li> <li>• An overview of local authority law and how Administering Authorities are constituted and operate</li> <li>• LGPS rules overview (including the Regulations, the Transitional Regulations and the Investment Regulations)</li> </ul>	
2.	<b>General pensions legislation applicable to the LGPS</b>	
	<p>An overview of wider legislation relevant to the LGPS including:</p> <ul style="list-style-type: none"> <li>• Automatic Enrolment (Pensions Act 2008)</li> <li>• Contracting out (Pension Schemes Act 1993)</li> <li>• Data protection (Data Protection Act 1998)</li> <li>• Employment legislation including anti-discrimination, equal treatment, family related leave and redundancy rights</li> <li>• Freedom of Information (Freedom of Information Act 2000)</li> <li>• Pensions sharing on divorce (Welfare Reform and Pensions Act 1999)</li> <li>• Tax (Finance Act 2004)</li> </ul>	

3.	<b>Role and responsibilities of the Local Pension Board</b>	
	<ul style="list-style-type: none"> <li>• Role of the Local Pension Board</li> <li>• Conduct and conflicts</li> <li>• Reporting of breaches</li> <li>• Knowledge and understanding</li> <li>• Data protection</li> </ul>	
4.	<b>Role and responsibilities of the Administering Authority</b>	
	<ul style="list-style-type: none"> <li>• Membership and eligibility</li> <li>• Benefits and the payment of benefits</li> <li>• Decisions and discretions</li> <li>• Disclosure of information</li> <li>• Record keeping</li> <li>• Internal controls</li> <li>• Internal dispute resolution</li> <li>• Reporting of breaches</li> <li>• Statements, reports and accounts</li> </ul>	
5.	<b>Funding and Investment</b>	
	<ul style="list-style-type: none"> <li>• Requirement for triennial and other valuations</li> <li>• Rates and adjustments certificate</li> <li>• Funding strategy statement</li> <li>• Bulk transfers</li> <li>• Permitted investments</li> <li>• Restrictions on investments</li> </ul>	

	<ul style="list-style-type: none"> <li>• Statement of investment principles</li> <li>• CIPFA guidance</li> <li>• Appointment of investment managers</li> <li>• Role of the custodian</li> </ul>	
6.	<b>Role and responsibilities of Scheme Employers</b>	
	<ul style="list-style-type: none"> <li>• Explanation of different types of employers</li> <li>• Additional requirements for admission bodies</li> <li>• Automatic Enrolment</li> <li>• Deduction and payment of contributions</li> <li>• Special contributions</li> <li>• Employer decisions and discretions</li> <li>• Redundancies and restructuring (including the Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006)</li> <li>• TUPE and outsourcing (including Fair Deal and the Best Value Authorities Staff Transfers (Pensions) Direction 2007)</li> </ul>	
7.	<b>Tax and Contracting Out</b>	
	<ul style="list-style-type: none"> <li>• Finance Act 2004</li> <li>• Role of HMRC</li> <li>• Registration</li> <li>• Role of 'scheme administrator'</li> <li>• Tax relief on contributions</li> <li>• Taxation of benefits</li> <li>• Annual and lifetime allowances</li> </ul>	

	<ul style="list-style-type: none"> <li>• Member protections</li> <li>• National Insurance</li> <li>• Contracting out (Pensions Scheme Act 1993)</li> <li>• Impact of abolition of contracting out in 2016</li> <li>• VAT and investments</li> </ul>	
8.	<b>Role of advisors and key persons</b>	
	<ul style="list-style-type: none"> <li>• Officers of the Administering Authority</li> <li>• Fund actuary</li> <li>• Auditor</li> <li>• Lawyers</li> <li>• Investment managers</li> <li>• Custodians</li> <li>• Administrators – in house v. third party</li> <li>• Procurement of services</li> <li>• Contracts with third parties</li> </ul>	
9.	<b>Key Bodies connected to the LGPS</b>	
	<p>An understanding of the roles and powers of:</p> <ul style="list-style-type: none"> <li>• Courts</li> <li>• Financial Services Authority</li> <li>• HMRC</li> <li>• Information Commissioner</li> <li>• Pensions Advisory Service</li> <li>• Pensions Ombudsman</li> </ul>	

	<ul style="list-style-type: none"> <li>• The Pensions Regulator (including powers in relation to Local Pension Boards)</li> </ul>	
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## **SCHEDULE B**

### **Summary of Legal Provisions to consider where an Administering Authority wishes to use an existing pensions committee as its Local Pension Board**

If you wish to use your existing pensions committee as the Local Pension Board you should take legal advice to ensure that the following provisions are complied with:

1. The provisions of Section 101 – Section 107 of the Local Government Act (the 1972 Act) which provides for the arrangements for the discharge of functions by local authorities. This enables non executive functions to be discharged by a committee, a sub-committee, a joint committee, another local authority or delegated to officers.
2. Section 102 (3) of the 1972 Act allows for people other than elected members to be co-opted to a committee. This is not permitted where a committee is responsible for regulating or controlling the finances of a local authority.
3. Section 102 (4) allows a local authority to appoint an advisory committee.
4. Section 106 provides for the procedures and quorum of meetings to be determined in Standing Orders or where provisions are not made in Standing Orders for the committee to determine its procedures.
5. Section 13 of the Local Government and Housing Act 1989 describes the voting rights for co-opted members of committees and gives rights of voting to co-opted members in specified circumstances. The general proposition is that co-opted members do not have voting rights. The provisions in section 13 which make exceptions to this rule are complex and their application will differ depending on whether functions are discharged by a committee or sub committee and whether a committee is decision making or advisory. There are exceptions for advisory committees and also where committees are established in accordance with regulations under the Superannuation Act 1972 (i.e. co-opted members have voting rights on these committees) and the Public Service Pensions Act 2013.
6. The provisions of regulation 106 (establishment) and regulation 107 (membership) of the draft LGPS (Amendment) (Governance) Regulations 2014 relating to Local Pension Boards.





## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: None
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## **Establishment of the Lancashire Pension Board**

Contact for further information:

George Graham, (01772) 538102, County Treasurer's Directorate,

[george.graham@lancashire.gov.uk](mailto:george.graham@lancashire.gov.uk)

### **Executive Summary**

The new Local Government Pension Scheme Governance regulations require each LGPS administering authority to create a Pensions Board to assist its work in managing its pension fund. This report sets out the proposed composition and terms of reference for the Lancashire Pension Board and asks the Committee to recommend these to the Full Council for approval.

### **Recommendation**

The Committee are recommended to

- i. Endorse the proposals for the Lancashire Pension Board set out in this report and recommend them to the County Council for adoption.
- ii. Recommend the County Council approve the dissolution of the Administration Sub Committee and approve the proposed revised terms of reference for the Committee set out at Appendix B.

## **Background and Advice**

The Local Government Pension Scheme (Amendment) Regulations 2014, consultation on which has previously been reported to the Committee are now at an advanced stage in the approval process and given the timescale for implementation it is necessary to put arrangements in place to ensure that the Lancashire County Pension Fund can comply with the regulations when they come into force.

### **Key Provisions**

The key provisions of the regulations are associated with the creation of a Pension Board in order:

- a) to secure compliance with:
  - i. the Regulations;
  - ii. other legislation relating to the governance and administration of the LGPS;

- iii. and the requirements imposed by the Regulator in relation to the LGPS, and
- b) to ensure the effective and efficient governance and administration of the LGPS.

It is important to note that the Board is not a committee set up under the Local Government Acts but a specific creation of the relevant regulations under public sector pension legislation, therefore requirements such as political balance do not apply. The Board is also not a decision making body, its role is to "assist" the Administering Authority and the Scheme Manager.

The regulations provide for a Board to be made up of equal numbers of employee and employer representatives with a minimum number of 2 of each, the latter giving an indication of the intention that these should be relatively small bodies. It is a matter for the administering authority (in this case the County Council) to make appointments to the Board and to assure itself that the Board is both representative of both employers and members of the Fund and that members of the Board meet the requirements for membership in terms of what the regulations describe as "relevant experience and capacity", but which in other contexts is referred to as knowledge and understanding.

There are restrictions on which County Council members or officers may be members of the Board in order to prevent conflict of interest. In essence from a member point of view it is not possible to be a member of both the Pension Fund Committee and the Pension Board, while no officer involved in the running of the Fund could be either an employer or employee representative.

It is possible to appoint other members to Boards who do not fall into either the employer or employee category, for example as an independent chair.

### **The Functions and Position of the Pensions Board in the Fund's Governance Structure**

The regulations and guidance clearly set out the role of the Pensions Board as a non-executive function while the Pension Fund Committee remains the decision making body in the new arrangements.

The roles of the various governance bodies are:

Administering Authority – The Full County Council responsible for making appropriate arrangements for the administration of the Fund.

Scheme Manager – The Pension Fund Committee responsible for the effective management of the Fund, with specific activities delegated to officers.

The Pension Board – Responsible for providing advice to ensure the above functions are carried out efficiently, effectively and in accordance with the relevant regulations.

It is expected that an ongoing dialogue will be maintained between the Pension Board and the Pension Fund Committee and that the Board will produce an annual report to the Full Council and would report to the Full Council if it identified any breach of regulations which the Committee determined not to address.

### **Proposed Composition of the Lancashire Board**

Given the need for a relatively small but representative body and to ensure that the Board is able to provide appropriate and knowledgeable challenge to the Pension Fund Committee as Scheme Manager it is proposed that:

1. The Lancashire Pension Board be chaired by an Independent Member with significant relevant experience either as a Pension Fund trustee or in the running of pension funds, preferably, within the Local Government Pension Scheme.
2. That the voting membership of the Board consist of 4 employer and 4 employee representatives.
3. That the 4 employee representatives be drawn:
  - a. 2 from active members of the Fund;
  - b. 1 from deferred members of the Fund;
  - c. 1 from pensioner members of the Fund.
4. That the 4 employer representatives be drawn:
  - a. 2 from Lancashire County Council
  - b. 1 from the other local authority employers within the Fund (excluding Parish and Town Councils);
  - c. 1 from all other employers within the Fund (including the Parish and Town Councils).

This provides representation for employers broadly in line with membership and while for employees membership in the three categories is roughly equally divided it is felt likely to be easier to secure representation from the active membership.

It will be a separate matter for the County Council (in its role as the major employer within the Fund) and the other local authorities to determine whether to appoint elected members or officers to represent them.

### **Appointment Process**

The following appointment process, which meets the criteria of openness and transparency set out in the relevant guidance, is proposed for each category of membership:

1. Independent Chair – To be appointed following public advertisement in appropriate publications such as the Financial Times using an interview process similar to that for the Fund's independent investment advisers, but with representatives of the Full Council as administering authority.

2. Employer representatives – Through seeking nominations from the respective "constituencies". If there were more nominations than places then subject to all nominees satisfying the "relevant experience and capacity test" a ballot of the relevant employer group would be held. It is expected that the County Council would appoint representatives through its usual processes and the other local authorities through some mechanism such as the Lancashire Leaders' Group. However, for the other employers there is clearly the potential for a ballot to be required.
3. Employee representatives – Through seeking nominations from the respective "constituencies". If there were more nominations than places then subject to all nominees satisfying the "relevant experience and capacity test" a ballot of the relevant employee group would be held. While this process is potentially lengthy and more expensive than potential alternatives such as nomination by representative bodies it is the only process which is fully open and transparent giving an equal chance for all members of the Fund to be appointed, as set out in the relevant guidance.

It is proposed that appointments would be for four years, although for any councilors appointed this would be subject to the results of any election in the intervening period. A term of office of this length, with the potential for reappointment, provides the opportunity for members of the Board to develop a degree of expertise, which will be of value to the Board. If elected members of the County Council are appointed this will be mid-way through their four year term and thus there is the potential for some staggering in the turnover of members to be introduced from the beginning of the life of the Board which is desirable.

The "relevant experience and capacity" test will need to be applied in line with the provisions of the guidance produced by the Shadow Scheme Advisory Board to ensure both that it operates effectively, but at the same time does not operate as an unnecessary deterrent to potential members who are able to undertake appropriate development activity.

### **Remuneration of Board Members**

Consideration needs to be given to whether members of the Board should be remunerated and if so, how. Clearly there is the potential for member representatives who are still in employment either to be deterred from putting themselves forward or to be out of pocket as a result of being appointed if there is no remuneration.

The following would seem to be an approach which balances the various issues which arise in this difficult area. As these appointments are not subject to the standard local authority rules and therefore are not subject to the Remuneration Panel's recommendation these are matters for the Council, acting as Administering Authority to decide, although clearly reference to the policies and principles recommended by the Remuneration Panel is good practice.

1. All members of the Board shall be reimbursed for travel and subsistence expenses they have actually and necessarily incurred in the conduct of their duties as a member of the Board, including attendance at relevant training and development activities. Rules in relation to the production of receipts etc. would apply.
2. In relation to members of the Board who are not councilors and are in employment, their employer will be able to reclaim a sum equivalent to salary, employers' national insurance contributions and employers' pension contributions, in respect of time spent by the individual in fulfilling their duties as a member of the Board, including attendance at relevant training and development activities.

The above attempts to ensure that no member of the Board will be out of pocket as a result of their membership and seeks to remove potential disincentives to membership while not providing a solely financial incentive to take part in the work of the Board.

For Councilors who are appointed to the Board the role would be part of the various council appointments they take on. It is therefore a matter for the particular Council making the appointment to consider how the responsibilities of membership should be dealt with as part of the relevant Members Allowance Scheme.

The role of Chair is different to those of other members as the aim is to seek an individual with both a significant degree of knowledge and experience and also the stature to guide the work of the Board. It is also likely that the Chair will have to undertake work in addition to attendance at meetings of the Board and attendance at training and development events, for example attendance at agenda planning meetings, and preparation of the Board's Annual report. If the analogy of the Members' Allowance Scheme is maintained then this would indicate some degree of "special responsibility" for which an allowance would be appropriate. Bearing in mind both the nature of the work required and the necessity to attract an individual of appropriate standing to this role it is suggested that an allowance of £10,000 per annum increased each April by the Retail Prices Index the previous September be approved. This is roughly 30% of the base fee payable to the Fund's Independent Investment Advisers whose commitment amounts to at least 1 day per month plus an expectation around maintaining the currency of their knowledge, responding to enquiries and dealing with issues through correspondence. While the input required of the Chair cannot easily be determined in advance the same basic requirement of attending meetings and training sessions maintaining knowledge and dealing with issues through correspondence will be required. As this is driven by the four meetings of the Board which is about 1/3 of the number of meetings for the advisers a base rate of c. 1/3 of the advisers seems appropriate.

### **Terms of Reference**

It will be necessary to agree appropriate terms of reference for the Board and reflect these within the Fund's Governance Policy Statement, which is, in effect the constitution for the Fund.

Attached at Appendix A are draft terms of reference for approval by the Full Council. These are somewhat fuller than would usually be the case as they need to be able to stand in isolation from the rest of the Council's constitutional documents.

### **Implications of the Creation of the Pension Board for the Fund's Existing Governance Arrangements**

The creation of the new Pension Board with an explicit compliance role presents, as it develops, the opportunity to review the Fund's existing Governance arrangements as part of work being undertaken by the County Council to review its overall governance arrangements.

Within any review of this sort key factors are likely to be:

- The size, effectiveness and manageability of the Committee (the current committee is 21 members against an average in England and Wales of 10 with most in the range 10-15) ;
- The representativeness of the Committee in terms of the various employer and member interests within the Fund, bearing in mind its responsibility to exercise functions of the County Council.
- The division of responsibility between the Committee and officers.

The conduct of any review of this sort is a matter for the County Council through the appropriate mechanisms. In the interim the creation of the Board creates the potential for some overlap in agendas with the Administration Sub Committee, and it is therefore recommended that the Committee recommend to the Council the abolition of this sub-committee and the amendments to its own terms of reference reflecting this set out at Appendix B. As well as reflecting the abolition of the Administration Sub Committee the opportunity has also been taken to structure the terms of reference more in line with the themes of activity undertaken by the Committee.

### **Timetable**

The first meeting of the new Board has to be held before July 2015 with the membership of the Board in place by April 2015. Subject to approval of the arrangements set out in this report by the full County Council in December this should be achievable and an outline timetable is set out below. The process for the Independent Chair will run in parallel with this.

Selection by ballot	
By 9 January 2015	Invite Nominations
By 15 February 2015	Circulate ballot papers (if required)
1 March 2015	Closing date for ballot papers to be returned (if required)
2 March 2015	Counting of ballot papers and declaration of results (if required), successful candidates advised.
3 March 2015	Appointment details on LCPF website
27 March 2015	Report results of process to Pension Fund Committee

Following appointment a training programme will be arranged for all members of the new Board prior to it commencing its work.

### Consultation

Any views received from the employer community and staff representative bodies will be reported orally at the meeting.

In general the responses received at the time of writing are either supportive or raise questions of detail, however, Unison in the North West made the following specific points:

1. They would prefer to see 5 member representatives and 5 employer representative as they feel this would be the appropriate size Board for a Fund of this size. The size of the Fund should not be a determining factor in the size of the Board, rather the size should be determined by the ability for the Board to be effective. In addition given the way in which 5 employer seats would logically have to be divided the County Council would begin to have a predominant influence which defeats the objective of the Board providing a genuinely independent oversight function.
2. They feel that it is inappropriate to have an independent chair. This is clearly a difference of opinion, but it is the view of officers that the additional knowledge and expertise that this role will provide will add to the effectiveness of the Board in providing appropriate challenge and scrutiny.
3. They would prefer all member representatives to be active members. This would not be in line with the guidance which indicates that all members of the Fund should be represented, which includes both pensioner and deferred members. It is, though, accepted that representatives of pensioner and deferred members may be more difficult to secure.
4. Unison are clear that they believe that Trade Union facility time should be provided for those acting as member representatives. This is a matter for individual employers, but the financial arrangements suggested in this report similarly are intended to ensure that there is no disincentive to employers to release staff, or to employees to put themselves forward.

5. Unison indicate a commitment to provide training for members who wish to become members of Boards, which is welcomed.
6. Unison express a preference for five year terms of office, which is the maximum suggested in the guidance. The suggestion of four years is a matter of administrative convenience to align with electoral cycles where councillors are appointed as members of the Board.

### **Implications:**

#### **Risk management**

The creation of the Board and its effective operation is intended to reduce the Fund's exposure to a range of risks associated with compliance with regulations and the Pensions Regulator's code for public service schemes,

#### **Financial**

Any costs incurred in the establishment and running of the Pension Board are chargeable to the Pension Fund under the terms of the relevant regulations.

Local Government (Access to Information) Act 1985  
List of Background Papers

Paper	Date	Contact/Directorate/Tel
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Reason for inclusion in Part II, if appropriate

N/a



# **Pension Board of the Lancashire County Pension Fund**

## **Terms of Reference and Delegated Authorities**

### **1) Role of the Local Pension Board**

The role of the Lancashire Pension Board as defined by sections 5 (1) and (2) of the Public Service Pensions Act 2013, is to –

- a) To assist Lancashire County Council as Administering Authority in its role as Scheme Manager; –
  - i. to secure compliance with the LGPS regulations and any other legislation relating to the governance and administration of the LGPS
  - ii. to secure compliance with requirements imposed in relation to the LGPS by the Pensions Regulator
  - iii. in such other matters as the LGPS regulations may specify
- b) To secure the effective and efficient governance and administration of the LGPS for the Lancashire County Pension Fund
- c) To provide the Scheme Manager with such information as it requires to ensure that any member of the Pension Board or person to be appointed to the Pension Board does not have a conflict of interest.

The Pension Board will ensure it effectively and efficiently complies with the code of practice on the governance and administration of public service pension schemes issued by the Pension Regulator.

The Pension Board will also help ensure that the Lancashire County Pension Fund is managed and administered effectively and efficiently and complies with the code of practice on the governance and administration of public service pension schemes issued by the Pension Regulator.

The Pension Board shall meet sufficiently regularly to discharge its duties and responsibilities effectively, but not less than four times in any year.

### **2) Membership and Appointment Process**

The Pension Board shall consist of 9 members and be constituted as follows:

- a) 4 employer representatives, of whom;
  - i. 2 shall be nominated by Lancashire County Council, where these are councilors or officers they shall meet the requirements of the relevant regulations in relation to avoidance of conflict with the County Council's role as Administering Authority:

- ii. 1 shall be nominated by the Unitary, City, and Borough Councils and the Police and Fire bodies which are employers within the Lancashire County Pension Fund;
  - iii. 1 shall be nominated by all other employers within the Fund.
- b) 4 scheme member representatives of whom;
  - i. 2 shall represent and be drawn from active members of the Lancashire County Pension Fund;
  - ii. 1 shall represent and be drawn from pensioner members of the Lancashire County Pension Fund;
  - iii. 1 shall represent and be drawn from deferred members of the Lancashire County Pension Fund.
- c) 1 independent member selected by the Scheme Manager, who shall not be a member of the Lancashire County Pension Fund and who shall be appointed as Chair of the Board. Such appointment will only be made following an openly advertised competition for the role.

Members in all categories will only be appointed to the Board by the Scheme Manager if they meet the skill and knowledge requirements set out in the relevant regulations and guidance, and as set out in section 7, below.

Members of the Board in categories a) iii., and b) i., ii., and iii., shall only be appointed after all employers or members of the Fund in those categories have been invited to put forward nominations. Where there is more than one nomination in any category then any nominee who meets the relevant knowledge and skills requirement will be included on a ballot of all members or employers in the relevant category. The winner in such a ballot will be the candidate with the greatest number of votes under the "first past the post" method.

Members of the Board will serve for a term of four years. Other than as a result of retirement at the expiry of this period the term of office will come to an end:

- a) For employer representatives who are councilors if they cease to hold office as a councillor;
- b) For employer representatives who are not councilors when they cease to be employed by the employing body where they were employed on appointment;
- c) For scheme member representatives if they cease to be a member of the relevant member group.

Each Board member should endeavour to attend all Board meetings during the year and is required to attend at least 3 meetings each year. Given the nature of the Board as a supervisory body and the need for appropriate knowledge and skills and the clear avoidance of conflicts of interest substitute members are not permitted.

In the event of consistent non-attendance by any Board member, then the tenure of that membership should be reviewed by the other Board members in liaison with the Scheme Manager.

Other than by ceasing to be eligible as set out above, a Board member may only be removed from office during a term of appointment by the unanimous agreement of all of the other members. The removal of the independent member requires the consent of the Scheme Manager.

### **3) Quorum**

The Board shall not be quorate unless the Chair and at least 2 employer representatives and 2 scheme member representatives are present.

### **4) Conflicts of Interest**

The policy for identifying conflicts of interest is set out in a separate policy document.

### **5) Board Review Process**

The Board will undertake each year a formal review process to assess how well it and its members are performing with a view to seeking continuous improvement in the Board's performance.

### **6) Advisers to the Board**

The Board may be supported in its role and responsibilities through the appointment of advisers, in addition to the Scheme Manager's officers and the Fund's various advisers and shall, subject to any applicable regulation and legislation from time to time in force, consult with such advisers to the Board and on such terms as it shall see fit to help better perform its duties.

The Board shall ensure that the performances of the advisers so appointed are reviewed on a regular basis.

### **7) Knowledge and Skills**

A member of the Pension Board must be conversant with –

1 The legislation and associated guidance of the Local Government Pension Scheme (LGPS).

2 Any document recording policy about the administration of the LGPS which is for the time being adopted by the Lancashire County Pension Fund.

A member of the Pension Board must have knowledge and understanding of –

a) The law relating to pensions, and

b) Any other matters which are prescribed in regulations.

It is for individual Pension Board members to be satisfied 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.

In line with this requirement Pension Board members are required to be able to demonstrate their knowledge and understanding and to refresh and keep their knowledge up to date. Pension Board members are therefore required to maintain a written record of relevant training and development.

Pension Board members will undertake a personal training needs analysis and regularly review their skills, competencies and knowledge to identify gaps or weaknesses.

Pension Board members will comply with the Scheme Manager's training policy.

### **8) Board Meetings – Notice Minutes and Reporting**

The Scheme Manager shall give notice to all Pension Board members of every meeting of the Pension Board, and shall ensure that all papers are published on the Lancashire County Pension Fund Website at least 5 working days prior to each meeting. These may at the discretion of the Scheme Manager be edited to exclude items on the grounds that they would either involve the likely disclosure of exempt information as specified in Part 1 of Schedule 12A of the Local Government Act 1972 or it being confidential for the purposes of Section 100A(2) of that Act and/or they represent data covered by the Data Protection Act 1998.

The Scheme Manager shall ensure that a formal record of Pension Board proceedings is maintained. Subsequent to each meeting the Chair will be asked to approve the minutes for publication as a draft and circulation to all members of the Board.

The Pension Board shall on an annual basis produce a report on both the nature and effect of its activities for consideration by the Administering Authority. The contents of this annual report will be subject to consideration and agreement at a meeting of the Board, but should include, inter alia:

- a) Details of the attendance of members of the Board at meetings,
- b) Details of the training and development activities provided for members of the board and attendance at such activities;
- c) Details of any recommendations made by the Board to the Scheme Manager and the Scheme Manager's response to those recommendations;
- d) Details of the costs incurred in the operation of the Board

The Board in considering items of business at its ordinary meetings shall in relation to each item consider whether it wishes to make a recommendation to the Scheme Manager, to which the Scheme Manager shall respond at the subsequent meeting.

### **9) Remit of the Board**

The Pension Board must assist the Scheme Manager with such other matters as the scheme regulations may specify. It is for scheme regulations and the Scheme Manager to determine precisely what the Pension Board's role entails. This role involves but is not limited to oversight and comment on:

- Performance standards;
- Customer service standards;
- Data quality and record keeping;
- Relative and absolute costs of running the fund;
- Learning from appeals and complaints;
- The application of specific policies within the fund, and
- The steps required to address any deficit within the fund.

### **10) Standards of Conduct**

The role of Pension Board members requires the highest standards of conduct and therefore the "seven principles of public life" will be applied to all Pension Board members and embodied in their code of conduct.

These principles are –

- Selflessness
- Integrity
- Objectivity
- Accountability
- Openness
- Honesty
- Leadership

### **11) Decision making**

Each member of the Pension Board will have an individual voting right but it is expected the Pension Board will as far as possible reach a consensus. The Chair of the Pension Board will not have a final deciding vote.

### **12) Publication of Pension Board information**

Scheme members and other interested parties will want to know that the Lancashire County Pension Fund is being efficiently and effectively managed. They will also want to be confident that the Pension Board is properly constituted, trained and competent in order to comply with scheme regulations, the governance and administration of the scheme and requirements of the Pension Regulator. Up to date information will be posted on the Lancashire County Pension Fund website showing

- The names, contact details and other relevant information about the Pension Board members
- How the scheme members are represented on the Pension Board
- The responsibilities of the Pension Board as a whole
- The full terms of reference and policies of the Pension Board and how they operate
- Details of the Pension Board appointment process
- Any specific roles and responsibilities of individual Pension Board members.

The Scheme Manager will also consider requests for additional information to be published or made available to individual scheme members to encourage scheme member engagement and promote a culture of openness and transparency.

### **13) Accountability**

The Pension Board will be collectively and individually accountable to the Scheme Manager.

### **14) Expense Reimbursement and Remuneration**

All members of the Board shall, on the production of relevant receipts be reimbursed for travel and subsistence expenses they have actually and necessarily incurred in the conduct of their duties as a member of the Board, including attendance at relevant training and development activities.

Members of the Board shall be reimbursed a mileage allowance for use of their own car at the rate proscribed by the Inland Revenue from time to time as adopted by Lancashire County Council.

Where members of the Board are in employment their employer will be able to reclaim from the Lancashire County Pension Fund a sum equivalent to salary, employers' national insurance contributions and employers' pension contributions, in respect of time spent by the individual in fulfilling their duties as a member of the Board, including attendance at relevant training and development activities.

The Chair of the Board shall receive a fixed annual allowance set initially (2015) at £10,000 pa (in addition to travel and subsistence expenses) to be inflated in April each year by the retail price index for the previous September.

### **15) Reporting Breaches**

Any breach brought to the attention of the Pension Board, whether potential or actual, shall be dealt with in accordance with the procedure set out in a separate policy document.

### **16) Definitions**

The undernoted terms shall have the following meaning when used in this document:

*“Pension Board” or “Board”*

Means the local Pension Board for the Lancashire County Council as administering authority for the Lancashire County Pension Fund as required under the Public Service Pensions Act 2013

*“Scheme Manager”*

Means the Pension Fund Committee as administering authority of the Lancashire County Pension Fund.

*“Chair”*

The individual responsible for chairing meetings of the Board and guiding its debates.

*“LGPS”*

The Local Government Pension Scheme as constituted by the Local Government Pension Scheme Regulations 2013, the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 and the The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

*“Scheme”*

Means the Local Government Pension Scheme as defined under “LGPS”

## **Proposed Revised Terms of Reference for the Pension Fund Committee**

### **Pension Fund Committee**

#### **Composition and role**

1. The Pension Fund Committee ("the Committee") comprises fourteen County Councilors and seven voting co-optees representing the following organisations:
  - a. One co-optee representing the Further and Higher Education sector in Lancashire;
  - b. One co-optee from Blackburn with Darwen Council;
  - c. One co-optee from Blackpool Council;
  - d. Two co-optees representing Trade Unions; and
  - e. Two co-optees representing the Lancashire borough and city councils.
2. The role of the Committee is to:
  - a. Fulfil the role of Scheme Manager, as set out in regulations, of the Lancashire County Pension Fund ("the Fund");
  - b. establish policies in relation to investment management, which shall include meeting with the Investment Panel to consider future Investment policy for the Fund;
  - c. monitor and review investment activity and the performance of the Fund; and
  - d. present an annual report to the Full Council on the state of the Fund and on the investment activities during the preceding year.
3. Meetings of the Committee shall be open to the public, but the public may be excluded where information of an exempt or confidential nature is being discussed – see Access to Information Procedure Rules set out at Appendix 'H' to the County Council's Constitution.

#### **Terms of Reference**

##### **General**

1. To exercise Lancashire County Council's responsibility for the management of the Fund, including the administration of benefits and strategic management of Fund assets and liabilities.
2. To determine which pension related functions and responsibilities should be exercised under the Council's Scheme of Delegation to Chief Officers.
3. To review governance arrangements and the efficient and effective use of external advisors to ensure good decision-making.
4. To appoint a minimum of two suitable persons to an Investment Panel through a sub committee convened for that purpose.



5. To meet at least quarterly, or otherwise as necessary, with the Investment Panel in attendance
6. To approve the overall appropriate and necessary training requirements for members of the Committee.

#### Policy and Strategic Planning

7. To approve the following key policy documents:
  - a) A rolling 3 Year Strategic Plan;
  - b) Statement of Investment Principles,
  - c) Governance Policy Statement
  - d) Governance Compliance Statement.
  - e) Pension Fund Annual Report, including the Annual Administration Report.
  - f) The Funding Strategy Statement to include the Fund's policy in respect of:
    - i. the Funding Target;
    - ii. the collection of employee contributions;
    - iii. the collection of employer contributions;
    - iv. the collection of additional employer contributions; and
    - v. Admissions and Terminations.
  - g) Pensions Administration strategy statement;
  - h) Communication Policy statement;
  - i) Internal Dispute Resolution Procedure;
  - j) Death Grant Procedure;
  - k) Bulk Transfer Payment Policy;
  - l) Commutation policy (small pensions);
  - m) Transfer policy; and
  - n) Abatement policy

#### Monitoring Performance

8. To receive periodic reports from the Director – Lancashire County Pension Fund to ensure that best practice is being adopted and value for money being delivered in relation to
  - a. The performance of the Fund's investments;
  - b. The performance of the Fund's administration service

#### Investment

9. To have overall responsibility for investment policy.
10. To approve and review on a regular basis an overall Investment Strategy and subsidiary Strategies for such asset classes as the Investment Panel consider appropriate.
11. To submit an annual report to the Full Council on the performance and state of the Fund and on the investment activities during the year.
12. To approve the policies and procedures for any internally managed Fund investments.

## Procurement

13. To approve the procurement process, tender award criteria and evaluation methodology in advance of any tender being invited for the appointment of external advisers and other external assistance in relation to the management of the Fund, to include:
  - a. external Investment Managers to discharge functions to be determined by the Committee relating to the management of the Fund's investments;
  - b. external property agents and advisors;
  - c. an external corporate governance adviser;
  - d. an external Fund custodian;
  - e. external performance measurement advisers;
  - f. the Fund Actuary; and
  - g. the Fund's AVC Provider.

## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: <u>None</u>
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### **Impact of Lancashire County Council's Transformation Programme on the arrangements for managing the Lancashire County Pension Fund**

Contact for further information:

George Graham, (01772) 538102, County Treasurer's Directorate,

[george.graham@lancashire.gov.uk](mailto:george.graham@lancashire.gov.uk)

#### **Executive Summary**

Lancashire County Council, which is the administering authority for the Lancashire County Pension Fund, is undertaking a major organisational transformation programme. This report sets out for the information of members of the Committee the implications of this programme for the arrangements for managing the Lancashire County Pension Fund.

#### **Recommendation**

The Committee are recommended to note the contents of this report.

#### **Background and Advice**

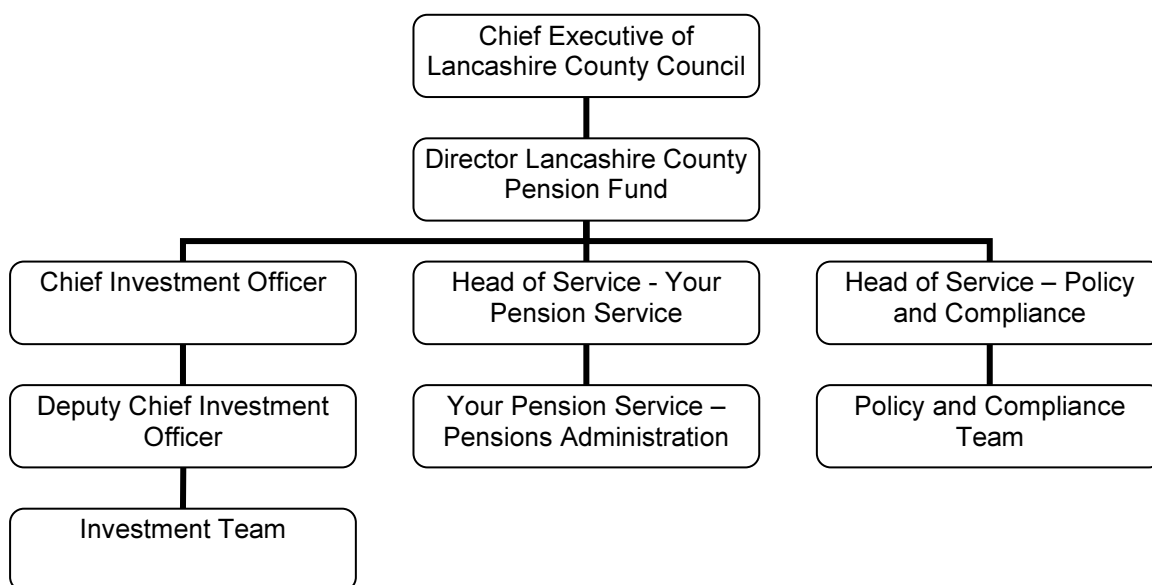
The ongoing reductions in public spending mean that all local authorities face having to make significantly reductions in spending over the coming years. For Lancashire County Council the scale of the forecast reductions is some £315m over the period 2014 – 2018. To achieve this financial reality, the Council is seeking to ensure that organisationally it is as effective as possible at delivering services, and that a new service offer is developed, setting out in an open and transparent way what can be delivered within the resources available. This will be delivered through a fundamentally redesigned organisation.

The redesign of the organisation was approved by Cabinet on 9 October 2014, and the process of populating the new structure has begun. Within this redesign, the Council's Chief Executive has taken the opportunity to strengthen the arrangements for delivering the Council's responsibilities as administering authority for one of the largest pension funds within the Local Government Pension Scheme (LGPS).

In terms of the Pension Fund, the context for the development of these proposals is set by the continuing reform of the public sector pensions' landscape including, from 2015, a new role for the Pensions Regulator with a keen focus on the issues of conflict of interest between funds and their "sponsor". There is, across many LGPS Funds an increasing move to more clearly separate the management and operation

of funds from that of their host councils, a move which is likely to be supported by work recently commissioned by the Shadow Scheme Advisory Board. Moves of this sort are entirely in line with the overall theme of professionalising the management of LGPS funds which has been supported by this Committee in its development of investment strategy, and in contributions to the debate on the future of the LGPS.

Taking all these various factors into account, the Council's Chief Executive has within the new organisational design created a separate organisational unit for the Lancashire County Pension Fund reporting directly to her. The senior management structure of this unit is set out in the diagram below:



This structure strengthens the current arrangements by bringing together the all aspects of the work of the Pension Fund under one senior manager whose time is fully dedicated to the Fund in a way that has not been possible up to now.

This revised management structure will require a review of the Fund's governance, as the current delegation from the Committee to the County Treasurer will cease with effect from 1 April 2015, the date the new structure takes effect. It will be necessary to fully revise the Fund's scheme of governance and this will be brought to the next meeting in order to ensure that it is in place prior to the commencement of the new management structure on 1<sup>st</sup> April 2015.

It is the intention that the powers currently delegated to the County Treasurer in her role as Treasurer to the Fund will be delegated to the Director of the Pension Fund and that the Head of Policy and Compliance will undertake the compliance and due diligence role on the Investment Panel currently carried out by the Deputy County Treasurer, thus continuing the operation of effective checks and balances within the Fund's governance arrangements.

Further discussion is necessary over the allocation of the role of Appeals Officer for the Fund (under Stage 2 of the Internal Dispute Resolution Procedure) which is

currently carried out by the Deputy County Treasurer, but this will be carried out either by the Director of the Pension Fund or the Head of Policy and Compliance.

The County Council's s.151 Officer will continue to be the s.151 officer for the Fund with responsibility for ensuring the proper administration of the Fund's financial affairs, and in particular the production of the Fund's accounts. The separation of the s.151 role from the role of running the fund in this way is common in the larger metropolitan funds with which the Lancashire County Pension Fund is most similar in terms of the scale of operation.

The County Council's Internal Audit Service will continue to provide a service both to the Committee and to management in terms of reviewing the Fund's overall system of internal control and providing an annual report on their findings.

### **Consultations**

N/a

### **Implications:**

This item has the following implications, as indicated:

### **Risk management**

By devoting dedicated senior management resource to the overall management of the Fund greater attention will be paid to the risks facing the Fund and it will be possible to develop greater levels of expertise in the management of pension funds which will be of longer term benefit to the Fund.

### **Financial**

The costs of the structure of the Pension Fund organisational unit set out in this report are fully recharged to the Pension Fund and any implications for the Fund following the completion of the County Council's appointment processes will be reported as part of a report on the budget for the running of the Fund which is scheduled for the March meeting of the Committee.

### **Local Government (Access to Information) Act 1985**

#### **List of Background Papers**

Paper	Date	Contact/Directorate/Tel
A New Employee Structure for Lancashire County Council	9 <sup>th</sup> October 2014	<a href="http://council.lancashire.gov.uk/ieListDocuments.aspx?CId=122&amp;MIId=3014">http://council.lancashire.gov.uk/ieListDocuments.aspx?CId=122&amp;MIId=3014</a>

Reason for inclusion in Part II, if appropriate

N/a



## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: <u>All</u>
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## **Report of the Appointments Sub Committee**

(Appendix A refers)

Contact for further information:

George Graham, 01772 538102, County Treasurer's Directorate

[george.graham@lancashire.gov.uk](mailto:george.graham@lancashire.gov.uk)

### **Executive Summary**

At its meeting on 6<sup>th</sup> June the Committee approved the convening of an ad hoc Appointments Sub Committee to appoint an Independent Investment Adviser to succeed Mr Mills.

This report presents the results of the Sub Committee's work.

### **Recommendation**

The Committee is asked to note the appointment of Ms Aoifinn Devitt as an Independent Investment Adviser to the Fund for an initial term of 2 years from 1<sup>st</sup> March 2015.

### **Background and Advice**

At its meeting on 6<sup>th</sup> June the Committee approved a process to appoint a successor for Mr Noel Mills as one of the Fund's Independent Investment Advisers. In order to provide for a handover period and to ensure a staggering in the end dates of the two adviser's contracts the Committee agreed that any new appointment should be from 1<sup>st</sup> March 2015.

Under the relevant constitutional arrangements the appointment of an Independent Investment Adviser is a decision for members of the Pension Fund Committee and consequently an ad hoc Appointments Sub Committee was convened to deal with the appointment, comprising:

County Councillor Terry Burns (Chair)

County Councillor Jackie Oakes

County Councillor David Westley

The Sub Committee met on two occasions on 30<sup>th</sup> September and 24<sup>th</sup> October, formal minutes of both meetings are attached at Appendix A. On the first occasion to shortlist candidates from the 10 applications received, and on the second occasion to interview the four shortlisted candidates. The Sub Committee were supported by the three officer members of the Fund's Investment Panel (County Treasurer, Chief Investment Officer, and Deputy County Treasurer).

The Sub Committee were very impressed with the overall standard of both the applications received and the candidates interviewed. The Sub Committee were unanimous in their decision to appoint Ms Aoifinn Devitt to the role.

Ms Devitt holds degrees in law from both Trinity College Dublin and the University of Oxford and an MBA from INSEAD (one of the world's top business schools based in France). She has worked in investment banking and investment consulting before starting her own investment consulting business. She is an adviser to another UK local authority fund and to a US endowment with similar requirements and has worked with other UK local authority funds on specific projects. She splits her time between Chicago and the UK and the fund will not be charged for her trans-Atlantic travel. Unfortunately Ms Devitt was not able to attend this meeting to observe the Committee but she will be present at the next meeting in March allowing her to meet members of the Committee.

### **Consultations**

N/A

### **Implications:**

N/A

### **Risk management**

N/A

### **Local Government (Access to Information) Act 1985**

#### **List of Background Papers**

Paper	Date	Contact/Directorate/Tel
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N/A

Reason for inclusion in Part II, if appropriate

N/A



## Lancashire County Council

### Pension Fund Appointments Sub-Committee

**Minutes of the Meeting held on Tuesday, 30th September, 2014 at 2.00 pm in Cabinet Room 'B' - The Diamond Jubilee Room, County Hall, Preston**

**Present:**

County Councillor Terry Burns (Chair)

**County Councillors**

J Oakes

D Westley

**1. Appointment of Chair**

**Resolved:** That County Councillor T Burns be appointed as Chair of the Sub-Committee for the purpose of appointing a new Independent Investment Adviser.

**2. Urgent Business**

None.

**3. Date of Next Meeting**

It was noted that the next meeting of the Sub-Committee would be held on Friday 24 October 2014 at 9.30am at County Hall, Preston.

**4. Exclusion of Press and Public**

**Resolved:** That the press and members of the public be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the paragraph of Part 1 of schedule 12A to the Local Government Act, 1972, indicated against the heading to the item. It was considered that in all the circumstances the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

**5. Appointment of Independent Investment Adviser  
Recommendations of the officer shortlisting meeting**

(Exempt information as defined in Paragraphs 1 and 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Sub-Committee considered applications submitted for the position of Independent Investment Adviser to the Lancashire County Pension Fund.

The Sub-Committee received the views of officers on the candidates' suitability for interview having regard to the agreed job role and specification.

Having carefully considered the applications and following discussion, the Sub-Committee agreed the candidates to be shortlisted for interview.

The Sub-Committee also considered the composition of the interviewing panel, and the proposed interview questions and timetable.

**Resolved:**

1. That the candidates identified by the Sub-Committee be shortlisted for interview on 24 October 2014.
2. That the composition of the interviewing panel and the interview arrangements, as set out in the report, be approved.
3. That the interview questions and scoring, and the interview timetable be agreed.

I Young  
County Secretary and Solicitor

County Hall  
Preston

## **Lancashire County Council**

### **Pension Fund Appointments Sub-Committee**

**Minutes of the Meeting held on Friday, 24th October, 2014 at 9.30 am in Christ Church Precinct - Room 202 - 2nd floor Christ Church Precinct**

#### **Present:**

County Councillor Terry Burns (Chair)

#### **County Councillors**

J Oakes

D Westley

#### **1. Apologies**

None.

#### **3. Disclosure of Pecuniary and Non-Pecuniary Interests**

None.

#### **3. Minutes of meeting held on 30 September 2014**

**Resolved:** That the Minutes of the meeting held on 30 September 2014 be confirmed and signed by the Chair.

#### **4. Urgent Business**

None.

#### **5. Exclusion of Press and Public**

**Resolved:** That the press and members of the public be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the paragraph of Part 1 of schedule 12A to the Local Government Act, 1972, indicated against the heading to the item. It was considered that in all the circumstances the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

#### **6. Appointment of Independent Investment Adviser**

(Exempt information as defined in Paragraphs 1 and 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Sub-Committee conducted interviews for the position of Independent Investment Adviser to the Lancashire County Pension Fund. Each candidate gave a brief presentation on a designated subject, and was then questioned by members of the Sub-Committee who were assisted by officers of the Investment Panel.

**Resolved:** That Aoifinn Devitt be appointed as Independent Adviser to the Lancashire County Pension Fund with effect from 1 March 2015 for an initial two year period.

I Young  
County Secretary and Solicitor

County Hall  
Preston

## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: None
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### **Shareholder voting and engagement**

(Appendices 'A', 'B', and 'C' refer)

Contact for further information:

Andrew Fox, (01772) 535916, County Treasurer's Directorate,

Andrew.fox@lancashire.gov.uk

#### **Executive Summary**

In accordance with its policies on promoting corporate social responsibility in the businesses in which it invests, the Fund seeks to influence companies' behaviour and ensure sound governance principles. The Fund achieves this through engaging Pensions and Investment Research Consultants Ltd (PIRC) as its Governance Adviser and also through the Local Authority Pension Fund Forum (LAPFF).

This report provides the latest quarterly update for the Committee on the work undertaken on the Fund's behalf by PIRC in accordance with current voting guidelines and the engagement activity undertaken by LAPFF.

The attached report from PIRC (Appendix A) covers the period 1 July 2014 to 30 September 2014. The Fund has voted on 318 occasions and has opposed or abstained in 39% of votes. PIRC recommends not supporting resolutions where it does not believe best governance practice is being applied. PIRC's focus has been on promoting independent representation on company boards, separating the roles of CEO and Chairman and ensuring remuneration proposals are aligned with shareholders' interests.

Details of the holdings of the Pension Fund in relation to the meetings held in this period are also given to provide more contextual information regarding the geographical and sector spread of the shareholder interests.

In addition, PIRC have provided a review of the proxy voting activity since 1 January 2014, which provides a summary of the votes cast and details of the types of resolution being voted upon. This is attached as Appendix B.

The attached engagement report from LAPFF (Appendix C) covers the period 1 July 2014 to 30 September 2014.

Details of potential class actions in relation to companies in which Lancashire County Pension Fund currently owns shares or has previously owned shares is also set out in the report.

#### **Recommendation**

It is recommended that:

1. The Committee note the report.

## Background and Advice

### 1. Shareholder Voting and Governance

- 1.1 The Fund has a longstanding policy of supporting good corporate governance in the companies in which it invests, and challenging companies who do not meet the standards set by their peers or reasonable expectations as measured by best practice.
- 1.2 The Fund's approach is part of its overall investment management arrangements and its intention to be a good asset owner for which its approach is developing. There are two main areas of responsible investment that the Fund focusses upon: **voting globally** and **engagement through partnerships**.

### 2. Global shareholder voting

- 2.1 PIRC, who act as the Fund's proxy and casts the Fund's votes at shareholder meetings, are instructed to vote in accordance with their guidelines unless the Fund instructs an exception. PIRC analyses investee companies and produces publically available voting recommendations to encourage companies to adhere to high standards of governance and social responsibility.
- 2.2 The analysis includes a review of the adequacy of environmental and employment policies and the disclosure of quantifiable environmental reporting. PIRC is also an active supporter of the Stewardship Code, a code of practice published by the Financial Reporting Council with the aim of enhancing the quality of engagement between institutional investors and companies.
- 2.3 PIRC also lobbies actively on behalf of its investing clients as well as providing them with detailed support. It works closely with NAPF (the National Association of Pension Funds) and LAPFF (the forum of Local Authority Pension Funds). The Lancashire County Pension Fund is a member of both these organisations.
- 2.4 PIRC's quarterly report to 30 September 2014 is presented at Appendix A. This report not only provides details of the votes cast on behalf of the Fund but also provides a commentary on events during the period relevant to environmental social and governance issues. It should be noted that if the Fund so wished, it retains the ability to cast a vote which does not accord with PIRC's recommendations.
- 2.5 The Fund's voting record using PIRC as its proxy for the three months ended 30 September 2014 is summarised below:

## GEOGRAPHIC VOTING OVERVIEW

Geographic Region	Meeting	Resolutions	For	Oppose	Abstain	Withheld	Say When on Pay	Non-Voting
SOUTH AND CENTRAL AMERICA	0	0	0	0	0	0	0	0
REST OF THE WORLD	1	63	23	38	2	0	0	0
ASIA	2	14	9	4	1	0	0	0
NORTH AMERICA	6	64	34	18	3	9	0	0
UK	6	120	94	16	10	0	0	0
EU	3	57	25	27	5	0	0	0
JAPAN	0	0	0	0	0	0	0	0

## ANALYSIS OF UK ALLSHARE VOTING RECOMMENDATIONS

Resolution Type	For	Percentage %	Abstain	Percentage %	Oppose	Percentage %	Total
Annual Reports	5	83.33	0	0.0	1	16.67	6
Remuneration Reports	3	50.0	1	16.67	2	33.33	6
Articles of Association	0		0		0		0
Auditors Appointment	1	16.67	5	83.33	0	0.0	6
Directors	49	85.96	3	5.26	5	8.77	57
Dividend	5	100.0	0	0.0	0	0.0	5
Executive Pay Scheme	0	0.0	0	0.0	2	100.0	2

- 2.6 The Fund was party to 318 resolutions during this period, of which 58% resulted in positive votes for shareholder resolutions and 39% were opposed or an abstention given. Voting abstention is regularly used by institutional investors as a way of signalling a negative view on a proposal without active opposition. In addition, within certain foreign jurisdictions, shareholders either vote for a resolution or not at all, opposition to these votes is described as vote withheld. These totalled 9 within the period, just over 3%.
- 2.7 Details of the votes made on the Fund's behalf during the period are set out in the following table, and gives the company name, the date of the meeting, the meeting type (typically Annual General Meeting (AGM) or Extraordinary General Meeting (EGM)), the country of incorporation, primary market sector, the value of Lancashire's holding in each company, and the voting details.

Lancashire County Pension Fund voting details 1 July 2014 - 30 September 2014

Company	Date	Type	Country	Sector	Holding (£)	Resolution Count	For	Oppose	Abstain	Withhold
EXPERIAN PLC	16/07/2014	AGM	United Kingdom	Professional Services	4,416,318	18	11	5	2	0
EMS-CHEMIE HOLDING AG	09/08/2014	AGM	Switzerland	Chemicals	3,396,994	11	6	3	2	0
SMUCKER (JM) CO.	13/08/2014	AGM	United States	Food Products	2,204,324	7	2	3	2	0
XILINX INC.	13/08/2014	AGM	United States	Semi-conductors	6,870,881	12	6	6	0	0
SAINSBURY (J) PLC	09/07/2014	AGM	United Kingdom	Food and Staples Retailing	867,280	20	18	2	0	0
NASPERS LTD	29/08/2014	AGM	South Africa	Media	22,238,924	63	23	38	2	0
FEDEX CORPORATION	29/09/2014	AGM	United States	Air Freight and Logistics	6,612,763	19	12	6	1	0
HERCULES TECH GROWTH CAP INC	08/07/2014	AGM	United States	Capital Markets	1,360,426	3	2	1	0	0
RYANAIR HOLDINGS PLC	25/09/2014	AGM	Ireland	Airlines	14,491,593	18	9	7	2	0
SINGAPORE POST LTD	04/07/2014	EGM	Singapore	Air Freight and Logistics	2,844,283	2	1	0	1	0
DIAGEO PLC	18/09/2014	AGM	United Kingdom	Beverages	29,847,181	22	16	4	2	0
SSE PLC	17/07/2014	AGM	United Kingdom	Electric Utilities	2,267,252	18	16	0	2	0
SINGAPORE POST LTD	04/07/2014	AGM	Singapore	Air Freight and Logistics	2,844,283	12	8	4	0	0
GREENE KING PLC	10/09/2014	AGM	United Kingdom	Hotels Restaurants and Leisure	2,396,150	17	13	2	2	0
COMPAGNIE FINANCIERE RICHEMONT SA	17/09/2014	AGM	Switzerland	Textiles, Apparel & Luxury Goods	15,509,369	28	10	17	1	0
NATIONAL GRID PLC	28/07/2014	AGM	United Kingdom	Multi-utilities	2,942,406	25	20	3	2	0
MEDTRONIC INC	21/08/2014	AGM	United States	Health Care Equipment & Supplies	9,876,194	17	9	1	0	7
NIKE INC.	18/09/2014	AGM	United States	Textiles, Apparel & Luxury Goods	4,953,361	6	3	1	0	2
						318	185	103	21	9



- 2.8 As mentioned at the June meeting of the Committee, PIRC have collated a review of proxy voting outcomes for the 2014 season and this is attached as Appendix B. The Managing Director of PIRC, Alan MacDougall, will be in attendance at the meeting and will be referring to this report as part of his presentation regarding shareholder voting and engagement and the effectiveness of the work undertaken by PIRC for the Fund.

### **3. Shareholder Engagement through LAPFF**

- 3.1 Lancashire County Pension Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), which exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest.
- 3.2 Members of the Committee may be interested to note the attached engagement report from LAPFF (Appendix C) which covers the period 1 July 2014 to 30 September 2014.
- 3.3 It sets out details of their activities in influencing governance, employment standards, reputational risk, climate change, finance and accounting, and Board composition, and provides a slightly different and wider perspective than the PIRC report.

### **4. Securities Litigation**

#### **United States**

- 4.1 The Fund has appointed Barrack, Rodos and Bacine (BR&B) and, more recently in addition, Robbins Geller Rudman and Dowd (RGRD) to provide securities litigation (class action) monitoring with the aim of ensuring that the Lancashire County Pension Fund receives all monies due to the Fund by filing its proof of claim from these cases. These services are at no cost to the Fund.
- 4.2 BR&B and RGRD will identify class actions where the Fund has a potential loss arising from an alleged fraud or a securities law violation. This is achieved through their respective monitoring systems which follows each potential securities case from the beginning to the end by ensuring its filing of the proof of claim so that the Fund may receive its payment.
- 4.3 Occasionally the Fund may be asked to participate in a class action, and/ or to apply to become the lead or co-lead plaintiff, but under US law any shareholder subject to such a loss will be automatically entered into and benefit from a class action without having to file an individual claim.
- 4.4 Details of current potential cases as at 30 September 2014 are set out below.

Company name	Effective class period begin	Effective class period end	Potential loss incurred (\$'000)
Medtronic, Inc	08/12/10	03/08/11	27.71
CenturyLink, Inc.	08/08/12	14/02/13	521.63
Barrick Gold Corp.	07/05/09	23/05/13	411.36
Intuitive Surgical, Inc.	19/10/11	18/04/13	251.54
ITT Educational Services, Inc.	24/04/08	25/02/13	760.06
Weightwatchers International	14/02/12	30/10/13	2,265.97

### United Kingdom

- 4.5 Unlike class actions within the US jurisdiction, where all relevant recipients benefit from a class action when filed, securities claims in the UK require investors to file their actions individually (i.e. be named as a Claimant on an issued Claim Form) in order to benefit from a successful action. Such actions are therefore much less prevalent.
- 4.6 The Committee will recall a current claim relating to the alleged actions of **Royal Bank of Scotland Group Plc (RBS)** where, it is argued, investors suffered losses in respect of a subsequent Rights Issue in 2008. An update was provided to the previous Committee in September 2014, and no significant developments have occurred since then.

### Consultations

N/A

### Implications:

It is a key component of good governance that the Fund is an engaged and responsible investor complying with the Stewardship Code.

Well run responsible companies are more likely to be successful and less likely to suffer from unexpected scandals.

### Risk management

The promotion of good responsible corporate governance in the companies the Fund is invested in reduces the risk of unexpected losses arising as a result of poor oversight and lack of independence.

Involvement in a non-US type of “class action” may result in losses incurred being recovered for the Fund, but should the claim be lost then the Fund may incur related costs which may not be known with certainty at the time of filing.

Should the claimants in the litigation against RBS fail, then it is possible that LCPF faces having to make a contribution towards RBS costs notwithstanding the insurance in place. The amount of any shortfall following an insurance settlement and the LCPF contribution thereto is impossible to quantify at this stage.

Furthermore, if successful the LCPF will be required to pay the amounts owing to SL under the Conditional Fee Agreement (insofar as not recovered from RBS) and pay a proportion of any sum recovered to the funder from the proceeds of the litigation.

## **Local Government (Access to Information) Act 1985**

### **List of Background Papers**

N/A





## LANCASHIRE QUARTERLY VOTING REPORT

### OVERVIEW

1. The Pension Fund received voting recommendations for **318** resolutions at **18** meetings in the quarter ended **2014-09-30**.
2. The Pension Fund supported **185** of the resolution (**58.18%**).
3. The Pension Fund voted against on **103** occasions (**32.39%**).
4. The Pension Fund abstained on **21** occasions (**6.6%**).
5. There were **0** non-voting agenda items (**0.0%**).
6. There were **9** withheld agenda items (**2.83%**).
7. There were **0** not supported agenda items (**0.0%**).

TABLE 1: GEOGRAPHIC VOTING OVERVIEW

Geographic Region	Meeting	Resolutions	For	Oppose	Abstain	Withheld	Say When on Pay	Non-Voting
SOUTH AND CENTRAL AMERICA	0	0	0	0	0	0	0	0
REST OF THE WORLD	1	63	23	38	2	0	0	0
ASIA	2	14	9	4	1	0	0	0
NORTH AMERICA	6	64	34	18	3	9	0	0
UK	6	120	94	16	10	0	0	0
EU	3	57	25	27	5	0	0	0
JAPAN	0	0	0	0	0	0	0	0

TABLE 2: ANALYSIS OF UK ALLSHARE VOTING RECOMMENDATIONS

Resolution Type	For	Percentage %	Abstain	Percentage %	Oppose	Percentage %	Total
Annual Reports	5	83.33	0	0.0	1	16.67	6
Remuneration Reports	3	50.0	1	16.67	2	33.33	6
Articles of Association	0		0		0		0
Auditors Appointment	1	16.67	5	83.33	0	0.0	6
Directors	49	85.96	3	5.26	5	8.77	57
Dividend	5	100.0	0	0.0	0	0.0	5
Executive Pay Scheme	0	0.0	0	0.0	2	100.0	2

TABLE 3: MEETINGS VOTE / NOT VOTED IN THE QUARTER

Company	Meeting Date	Type	Date Voted	Comment
SINGAPORE POST LTD	2014-07-04	EGM	2014-06-19	Voted
SINGAPORE POST LTD	2014-07-04	AGM	2014-06-19	Voted
HERCULES TECH GROWTH CAP INC	2014-07-08	AGM	2014-06-23	Voted
SAINSBURY (J) PLC	2014-07-09	AGM	Not Voted	No ballot generated
EXPERIAN PLC	2014-07-16	AGM	2014-07-09	Voted
SSE PLC	2014-07-17	AGM	2014-07-10	Voted
NATIONAL GRID PLC	2014-07-28	AGM	2014-07-21	Voted
EMS-CHEMIE HOLDING AG	2014-08-09	AGM	2014-07-23	Voted
SMUCKER (JM) CO.	2014-08-13	AGM	2014-08-08	Voted
XILINX INC.	2014-08-13	AGM	2014-08-08	Voted
MEDTRONIC INC	2014-08-21	AGM	2014-08-12	Voted
NASPERS LTD	2014-08-29	AGM	2014-08-20	Voted
GREENE KING PLC	2014-09-10	AGM	2014-08-26	Voted
COMPAGNIE FINANCIERE RICHEMONT SA	2014-09-17	AGM	2014-09-05	Voted
DIAGEO PLC	2014-09-18	AGM	2014-09-05	Voted
NIKE INC.	2014-09-18	AGM	2014-09-17	Voted
RYANAIR HOLDINGS PLC	2014-09-25	AGM	2014-09-15	Voted
FEDEX CORPORATION	2014-09-29	AGM	2014-09-17	Voted

TABLE 4: GEOGRAPHICAL COUNT OF ALL SUPPORTED MEETINGS

SOUTH AND CENTRAL AMERICA			
Meetings	Count All For	AGM	EGM
0	0	0	0
REST OF THE WORLD			
Meetings	Count All For	AGM	EGM
1	0	0	0
ASIA			
Meetings	Count All For	AGM	EGM
2	0	0	0
NORTH AMERICA			
Meetings	Count All For	AGM	EGM
6	0	0	0
UK			
Meetings	Count All For	AGM	EGM
6	0	0	0
EU			
Meetings	Count All For	AGM	EGM
3	0	0	0
JAPAN			
Meetings	Count All For	AGM	EGM
0	0	0	0



## Lancashire Quarterly Report

### **Vote Rejections**

PIRC was not notified of any vote rejections during the quarter.

### **Vote Changes**

PIRC was not notified of any client vote changes during the quarter.

## United Kingdom

### July

#### Law Commission Reports on Fiduciary Duty

##### Report clarifies relevance of ESG factors in trustee decision making

The [Law Commission](#) has released its long awaited [The Fiduciary Duties of Investment Intermediaries](#) report containing a range of guidelines and recommendations around investment issues.

Taking a lead from the Kay Review the report maintains a focus on longer-term decision making and defines various factors trustees may take into account in assessing both risks and returns in investment decision making. The report notes trustees should focus on investing for "realistic" returns rather than attempting to maximise short-term results.

Investment management turnover and consultants processes are also under scrutiny in the [full report](#) but most attention has centred around Commissions views on the interaction between ESG and sustainability considerations and fiduciary duty as expressed in the [Guidance for Pension Fund Trustees](#).

The Commission has balked at making an explicit recommendation for change in the current law, handing off to government a recommendation to review the current Occupational Pensions Schemes Regulation particularly around social, environmental or ethical considerations and the differences between financial and non-financial factors.

However, the Commission has expressed its views in reasonably clear language on materiality of financial considerations that a trustee should take account in investment decisions:

‘When investing in equities over the long-term, the risks will include risks to the long-term sustainability of a company’s performance. These may arise from a wide range of factors, including poor governance or environmental degradation, or the risks to a company’s reputation arising from the way it treats its customers, suppliers or employees.’

‘Where poor business ethics raise questions about a company’s long-term sustainability, “we would classify them as a financial factor which is relevant to risk.’

Further the materiality of issues a Trustee may take into account:

‘Any financial factor which is relevant to the performance of an investment. These include risks to a company’s long-term sustainability, such as environmental, social or governance factors (often referred to as “ESG” factors).’

The conclusion is that there is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material.

In a boost to member advocacy campaigns, the report has also outlined a two stage test for non financial factors that may be taken into account by Trustees, including member views on particular investments. Further recommendations encompass adding the new guidance into the Pensions Regulator [Trustee Toolkit](#) and potentially longer-term inclusion in the Code of Practice.

The report has been broadly welcomed with both the [PRI](#) and [NAPF](#) issuing positive statements.

### **No Butts or Bombs Says Croydon**

#### **Local Authority Fund Drops Tobacco, Arms and Nuclear Power from Investments**

The £705m [Croydon Council Pension Fund](#) has taken a lead on ethical investments by transferring all of its equity assets of around £350 million to a global ethical investment fund run by Legal and General.

The [decision](#) taken at the Fund earlier in June effectively disinvests the fund from exposure to tobacco, nuclear power and arms stocks.

‘Having a pension fund that invests in tobacco was very much at odds with our responsibility to protect and improve public health in this borough, and there were clearly a number of concerns about the ethics of doing that.’

‘Ensuring the council is a socially responsible investor was a key manifesto pledge for the administration.’ Chair of the committee councillor John Wentworth told [IPE](#).

Councillor Simon Hall, cabinet member for finance and treasury at the council and vice-chair of the pension committee added ‘Tobacco is not the low-risk, high-profit investment it once was...this really is in the best interests of the scheme’s beneficiaries and residents, both ethically and financially.’

Tobacco investments in particular have featured in debates around ethical and socially responsible investing [stretching back decades](#) with US endowments and mutual funds often taking the lead in the past. The giant Norwegian SWF divested from 17 tobacco related stocks [in 2010](#). The Australian Government sovereign [‘Future Fund’](#), leading industry funds [Cbus](#) and [HESTA](#), and large [public sector pension funds](#) at local, state and [federal level](#) have also quit tobacco in Australia.

Croydon is seen leading the way on tobacco with IPE [detailing mixed results](#) from other local authority funds to limit exposure or divest entirely.

The July [Law Commission Report](#) on fiduciary duties of investment intermediaries should give some further elbow room for trustees and funds to review the ESG considerations surrounding this kind of investment. With Big Tobacco mounting expensive legal challenges in [various jurisdictions](#) against Australia's pioneering and [successful](#) 'plain packaging' [reforms](#) despite losing a [High Court case](#), and [furiously lobbying](#) in the UK to block [similar legislation](#), it's reasonable for institutional investors to ask some serious questions about beneficiaries' interests..

Croydon Council Pension Fund has given its answer.

### August

#### Regulators toughen up banking rules

**PRA and FCA release joint consultation papers to improve individual accountability at banks.**

The [Prudential Regulation Authority](#) (PRA) and the [Financial Conduct Authority](#) (FCA) have released two joint consultation papers aimed squarely at improving individual responsibility and accountability in the banking and finance sector.

The proposed regulations are a further response to an industry blighted by a decade of scandals, a global crisis and an attitude to remuneration far adrift from any moorings around performance, shareholder value and community standards, issues all too frequently highlighted in PIRC Alerts over many years.

The first joint paper, [Strengthening accountability in banking: a new regulatory framework for individuals](#) proposes that senior individuals that 'have the potential to bring a bank to failure, or to cause serious harm to customers' will undergo approval to ensure their suitability for the role. The role of senior managers will have to be clearly defined to improve the regulators' capability of holding individuals to account.

The second paper, [Strengthening the alignment of risk and reward: new remuneration rules](#) set to come into force on 1<sup>st</sup> January 2015, seeks to strengthen clawback abilities on bonus payments.

The PRA and FCA also proposed paying bonuses over a minimum of five or seven years, depending on the employee's level of seniority, a method that is seen to align risk and reward.

The numerous wrongdoings that have emerged from the banking sector have largely seen individuals mostly go unpunished, while shareholder value has been consistently whittled away by multi-billion dollar impairment costs and record fines, with more in the pipeline.

Andrew Bailey, Chief Executive of the PRA said, 'Holding individuals to account is a key component of our job as regulators of banks. We believe that enhancing individual accountability and improving the alignment of risk and reward should have a positive impact on behaviour and culture within banks and will help to ensure that they are managed in a way that promotes the safety and soundness of individual institutions.'

The proposals have already attracted criticism. Anthony Browne from the [British Bankers' Association](#) (BBA) [told the BBC](#) "Bankers are paid less here [in London] than in New York, Singapore or Hong Kong, and ultimately this could have an impact on the competitiveness of London as a financial centre and the jobs and tax paid here."

"We have the world's largest international banking sector and we do have to make sure that we can continue to employ banking talent from around the world."

Santander CEO Ana Botin is [reported in The Telegraph](#) as fearing that 'seven-year clawbacks on bankers' bonuses could threaten London's position as a leading financial centre.'

In PIRC's view the evidence clearly shows that playing around with vesting periods of these lengths simply does not incentivise. Better to drop long term incentive plans altogether and enforce brutal law back arrangements in directors' contracts to recover rewards for failure.

Other comments allude to the spectre of a mass exodus of City bankers and financiers, hurriedly fleeing the UK for the sanctuary of alternative jurisdictions with less regulation. A mooted prospect that PIRC Alerts believes is unlikely to rouse the general populace into forming flying pickets, blockading channel ports and international departure terminals, clamouring for bankers to stay. And anyway, isn't banking a global business?

Any banker who sees working to an ethical standard embodying both trust and stewardship as an onerous weight to bear should consider a radical career change.

September

### New Governance Code Behind on Accounting

**FRC addresses remuneration, long term value and engagement. Accounting concerns still remain.**

The UK [Financial Reporting Council](#) has updated the [UK Corporate Governance Code](#) (the Code) with a series of amendments that attempt to address areas where corporate behaviour has been poor and shareholder concern has been high.

Some of the significant changes to the Code include:

- Companies should state whether they consider it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to their ability to continue to do so;
- Companies should robustly assess their principal risks and explain how they are being managed or mitigated;
- Companies should state whether they believe they will be able to continue in operation and meet their liabilities taking account of their current position and principal risks, and specify the period covered by this statement and why they consider it appropriate. It is expected that the period assessed will be significantly longer than 12 months; and
- Companies should monitor their risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report
- Greater emphasis to be placed on ensuring that remuneration policies are designed with the long-term success of the company in mind, and that the lead responsibility for doing so rests with the remuneration committee; and companies should put in place arrangements that will enable them to recover or withhold variable pay when appropriate to do so, and should consider appropriate vesting and holding periods for deferred remuneration.
- Companies should explain when publishing general meeting results how they intend to engage with shareholders when a significant percentage of them have voted against any resolution.

The changes are consistent with the directions foreshadowed by the FRC earlier in 2014 and reflect some of the views amongst asset owners that boards should focus more on longer term value. Remuneration structures must be aligned around this objective and higher levels of accountability to and engagement with shareholders is fundamental to good governance. Despite this, issues still remain.

### Accounts and Going Concern

The new Code does not reflect investor concerns about the wording of the going concern statement, and the placing of it within general risk statements. PIRC has been very clear that the true and fair view requirement of company law is a standard to discharge basic director duties of trading lawfully, as a solvent going concern, and making lawful distributions, based on a proper balance sheet and profit and loss account. That can be the only meaning per the construction of the 1947 Companies Act, where the true and fair view standard first appears as the standard for both the books of account at all times, and the annual accounts. That position is then properly reflected in the 2<sup>nd</sup>, 4<sup>th</sup> and 7<sup>th</sup> EU Directives. However, elements of the accounting profession over a long period of time misrepresented true and fair view as meaning something different, and given its genesis under the aegis of the accounting profession the FRC seems to have inherited the wrong version.

PIRC is therefore concerned that the Code may give the false impression that the discharge of directors going concern obligations can be done outside of audited accounts with non-audited information instead.

### Auditor Rotation

The Code has established 10 year comply or explain retendering of the audit appointment. That has now been somewhat superseded by EU regulations, creating a different test at 10 years and then 20 years and by the Competition and Market Authority draft orders proposing 5 year comply or explain retendering and 10 year compulsory retendering. The legislation to implement the CMA and EU proposals is still pending in the UK.

PIRC policy has consistently been that long tenure creates an independence threat to auditors, not only in terms of over familiarity, but inherent disincentives to discover and reveal past errors. The new regulatory environment should provide sufficient information on tenure to have a consistent voting outcome based on tenure.

PIRC policy on this matter is under review. PIRC believes that the process of auditors retendering as incumbent auditors may itself also create an independence threat in the event that difficult issues come to light for shareholders during or ahead of the retendering.

On the different policy concern of too few audit firms, which retendering is attempting to address, PIRC believes that the only practical solution is a cap on the market share that any one firm can have.

## Mandatory Voting on M&A adds value

### New study boosts case for shareholders to have final say on large merger deals

New academic research has found that obliging shareholders to vote on company acquisitions generates ‘substantial value’ and helps discourage the most reckless transactions.

The 64-page study – Does Mandatory Shareholder Voting Prevent Bad Acquisitions? was compiled by Marco Becht of the Université Libre de Bruxelles, Andrea Polo of Universitat Pompeu Fabra, and Stefano Rossi of the Krannert School of Management. It is part of a series from the European Corporate Governance Institute, a Brussels-based non-profit group.

The researchers have focused on the UK, where some aspects of merger & acquisition deals above 25% (‘Class 1’) can trigger shareholders votes. A Takeovers Panel also has an oversight role in M&As. The study looked closely at the failed £24bn (€30.37bn, bid by Prudential Plc for American International Group’s Asian life-insurance arm in 2010. The deal was opposed at the time by advisory firms RiskMetrics and PIRC and by a group of shareholders marshalled by Neptune Investment Management’s Robin Geffen.

It eventually collapsed with costs put at £377m.

‘Our results indicate that mandatory shareholder voting can generate substantial value improvements for acquiring shareholders,’ the report states.

The UK stands out from both the EU and US markets in votes on M&A proposals, in Europe there are no votes and in the US shareholder votes are not binding or can be sidestepped.

The team found that over in the period 1990-2010 UK Class 1 transactions, subject to a shareholder vote, were linked to an ‘aggregate gain to acquirer shareholders of \$US13.6bn.’



They add that US deals of a similar size –subject to shareholder approval – showed an aggregate loss of a whopping \$US210bn for acquirer shareholders. Furthermore, smaller so-called ‘Class 2’ M&A deals in the UK, Where votes are not mandatory, ‘are associated with an aggregate loss of \$US3bn’ over the same time period.

‘It is surprising that the UK model of governing large acquisitions has not been imitated in other markets dominated by widely held companies. Mandatory shareholder voting on large corporate acquisitions is a simple.

### **Norwegian Fund Intent on Transparency**

#### **Giant SWF will announce votes in advance of meetings for selected companies.**

One of the largest asset owners in the world has taken a welcome step in announcing that it will begin giving advanced notice of voting intentions at company meetings.

From next year, Norway’s Government Pension Fund Global (GPFG) will publish its voting intentions prior to meetings in an effort to ‘increase transparency, and encourage initiatives to strengthen the vote execution chain.’ Previously disclosure had only taken place a day after company meetings.

The move is seen as one that will increase pressure on boards to engage with GPFG and other investors on ESG issues.

The sheer size of the Norwegian fund, which holds on average 1.3% of every company listed worldwide and a higher 2.5% of every European listed company, means that any announcement it makes is likely to have a concomitantly wider impact among both asset owners and managers.

The wider influence of any announcement made by the fund largely rests on how far in advance it is made. The [Financial Times](#) notes that some large US pension funds including Calpers and Calstrs, make public their intentions, but usually not far enough ahead of a meeting to materially affect AGM votes.

Publishing its voting intentions is another development from the fund which has traditionally taken a leadership role on governance issues including remuneration, board composition ESG reporting, divestment and sustainability.

As part of its strategic direction the GPFG has also foreshadowed a more active intervention in director appointments in some of its larger holdings and an increase in the number of companies it will hold a 5% stake in.

The fund has also appointed a corporate governance advisory board which includes UK corporate governance expert John Kay, author of the landmark Kay Review.

It is inevitable that focus will now shift to other large asset owners with speculation over how many will follow suit and when. More and more members and beneficiaries are beginning to make connections between their pension accounts and the underlying holdings of their funds as the growing campaigns around carbon divestment demonstrate.

While its still a primarily a minority of members it is reasonable to assume this interest will grow over time.

At the other end of the scale, the traditional model of closed door discussions by asset managers and their voting decisions kept under wraps is a little more wobbly after this decision.

Transparency and disclosure go hand in hand with good governance and active shareholders.

The Norwegians have shown that it can be done.

### September

#### Differential Voting Rights Confirmed By Italian Parliament

**One Share One Vote principle watered down despite concerns.**

**The Italian Parliament has extended the thrust of Law Decree n.91 which came into force on 24<sup>th</sup> June opening the door to differential voting rights for shareholders. (See PIRC Alerts 12<sup>th</sup> August).**

**Decrees become lawful upon publication in the Official Gazette for a 60-day window but subsequently lapse unless they are converted into Parliamentary law during that period.**

**The original Decree of n.91/2014 was part of a raft of financial reforms introduced by the government and amongst many changes to financial and corporate law provided for additional voting rights for shares held continuously for 24 months sparking governance concerns.**

**The Parliament in converting the original Decree to Law n.116/2014 has added further measures that water down existing pro-independent shareholder protections and have the potential to entrench the influence of major shareholders.**

**To give effect to additional voting rights, amendments will be required to company by-laws. Those public companies that call an EGM prior to Jan 2015 will require only a simple majority vote as Parliament has temporarily suspended a long standing provision in Italian law that resolutions put on an extraordinarily basis require a two thirds majority to pass.**

**This provision is being seen to benefit a number of state controlled listed companies where the government controls around thirty per cent of share capital directly or as a result of indirect holdings through the Fund for Deposits or Cassa Depositi e Prestiti (CDP).**

**In effect, the by-laws can be changed and multiple share voting rights introduced without the consent of a majority of independent shareholders. Large enterprises such as Enel, Eni, Finmeccanica, Snam and Terna are seen amongst the primary beneficiaries of this move.**

**In a second major change**, shareholders not voting in favour at EGMs shall not have the 'right to withdraw', which governs conditions around share redemption, as is currently provided by Article 2437 of the Italian Civil Code on all resolutions modifying shareholders' voting rights.

Giuseppe Vegas, President of market regulatory authority Consob, opposed this provision in the Decree at a Senate hearing on the 2<sup>nd</sup> of July. Despite this opposition, the Parliament decided to eliminate this existing shareholder right.

The third issue centres on provision for mandatory takeover bids. Previously, a single shareholder who exceeded 30% of the share capital was required to launch a takeover bid. Under new Law n. 116/2014, the new threshold is a combination of share capital (30%) and voting rights (25%), if no other shareholders hold a greater stake.

However, a bid is not mandatory if the 25% threshold is exceeded following the assignment of the additional voting rights. Some confusion still exists over how this change will apply in practice with Consob due to issue clarifying regulations on December 31<sup>st</sup>.

In summary, the scope of the Law n. 116/2014 seems larger than that of the original Decree n. 91/2014. In addition to state-controlled companies, family-owned businesses and foundation-controlled financial institutions may also benefit from this provision, especially the latter.

The implication of these changes is a possible re-consolidation of the Italian shareholding panorama, back towards the previous 'strategic control' model, almost a direct response to recent market developments which had led to the dissolution of many long-term shareholder agreements and increased more free-float capital.

Independent shareholder rights and the ability engage and influence governance do not appear to be the priority. PIRC Alerts will follow developments as they unfold.

## SRI takes a step forward in Italy

### Sustainable Investment Forum agrees a definition for Responsible Investment.

The Italian Sustainable Investment Forum ([FFS](#)) has reached agreement on a common definition of sustainable and responsible investment (SRI) in advance of the [3rd Italian Sri Week](#), scheduled for early November.

“Sustainable and Responsible Investment is a medium to long term investment strategy which, in the evaluation of companies and institutions, combines the financial analysis with a robust environmental, social and governance (ESG) analysis, with the aim to create value to the benefit of investors and the society as a whole”

In a [press release](#) FFS Secretary General, Davide Dal Maso, states: ‘I believe this definition represents a good starting point and will give food for thought to the market players and the SRI community as a whole.’

Whilst Italy is perceived as lagging behind some other EU nations on development of SRI principles and ESG based engagement, progress is being made.

The [Assofondipensione](#) (Italian Pension Funds Association) has readied [draft correspondence](#) on behalf of [Cometa Fondo](#) Italys largest pension fund to go to all major banks [requesting information](#) on a range of climate financing and carbon risk issues.

As a starting point for collective actions and responsible investment, engaging with global banks on climate change would indicate the Italians believe its best to begin at the top of the mountain.

US

July

**Walgreens Tries Inversion  
SEC complaint filed over submerged briefing**

Giant US based drug retailer [Walgreens](#) has come under investor pressure in its mooted takeover of Alliance Boots and redomiciling to Switzerland following a complaint to the SEC from The [CtW Investment Group](#) (CtW).

The [CtW](#) is requesting an investigation into an alleged breach of legislation which prevents inside information being preferentially distributed amongst some shareholders pointing to confidential meetings held with hedge funds and analysts to discuss a possible tax driven move following its acquisition of Swiss registered pharmaceutical company Alliance Boots GmbH.

The investor group, which coordinates shareholder engagement union based pension funds holding \$250 AUM also charges that senior executives [materially misled](#) the public and investors by [denying](#) any plans to redomicile despite discussions with key investors around the matter.

“We are deeply troubled that Walgreens may have put the vast majority of its investors at a disadvantage while positioning influential hedge funds to profit from material, nonpublic information,” CtW senior researcher Michael Pryce-Jones said in a statement. “The issues described in the complaint raise broader concerns about management’s accountability to shareholders at a time when a major strategic transformation is on the table.”.

The Walgreen controversy has again [focused attention](#) on a tax skirting tactic called ‘inversion’ where US companies merge with foreign rivals in countries with lower tax rates and then reincorporate there while still enjoying the benefits of doing a large part of their business and retaining corporate HQs in the United States.

Walgreen is [reported](#) to earn over 25% of revenue from the federal government and has been the beneficiary of state based tax credits and [legislation](#) to peg prices its key service providers can charge for credit card transactions.

The wider impact on the US tax base of such a move is estimated by [Americans for Tax Fairness](#) to cost American taxpayers [\\$US4 billion over five years](#), with further impacts at its home base in Illinois.

Tax driven M&A activity should once more trigger questions from investors over long term strategies to create shareholder value. Walgreen has [resisted](#) efforts for more diversity in board representation despite a [43% vote in favour](#) at the last AGM and basic [governance questions](#) remain.

August

## White House gets going on Agriculture and Climate Risks

### PRI dives into water resourcing to help keep investors afloat in a sea of uncertainty

The [Principles for Responsible Investment](#) (PRI) today [launched](#) a new investor-led collaborative engagement, focused on the water risks faced by companies in their agricultural supply chains.

The water focus coincides with a [renewed push](#) from the White House on climate risk issues as part of President Obama's [Climate Data Initiative](#) with 'Food Resilience' the next cab of the rank from the Administration following the initial attention on coastal risks and resilience.

The PRI is one of the major private sector participants in the initiative which encompasses a range of projects and activities with agricultural science, data practices, production and resource practices to build [capability and capacity](#) of the sector to meet and attempt to mitigate expected climate related impacts.

As part of the shift towards agricultural sustainability in the face of climate change, the PRI has today released a [research report](#) on water developed in collaboration with the World Wildlife Fund ([WWF](#)) and PwC [Germany](#). The report highlights the risks to investors and underlying companies with guidance on shareholder engagement around changing water usage, scarcity and resourcing issues.

The PRI has also formed an investor group made up of Rockefeller & Co. and five European-based institutional investors comprising of PGGM, Aberdeen Asset Management, Hermes, MN, and Nordea to address the risks from climate change to companies with agricultural supply chains including users in food, beverage, and apparel sectors.

Using data from the World Wildlife Fund's (WWF) [Water Risk Filter](#) mapping tool and Pricewaterhouse Coopers' (PwC) [ESCHER model](#), the investor group will engage approximately 50 major companies in to increase resilience to water risks and foster more informed investment decision-making.

"We are proud to launch this project to highlight the risks companies face in their supply chains. We welcome proactive dialogue between investors and businesses to stimulate improved transparency and risk management practices, and in turn promote resilience in food production in an increasingly water scarce world." PRI CEO Fiona Reynolds said.

## US Proxy Season Shows some Promise

### Remuneration, board reforms, ESG issues reflect investors priorities and pressures.

As the proxy voting season for corporate America winds down a plethora of detailed [summaries](#) and [analysis](#) are available for asset owners, stakeholders and shareholder activist groups to ponder.

Despite many of the hurdles that US shareholders must jump in order to place a resolution before a meeting progress on good governance is being made.

PIRC is pleased to note the continued focus on [executive compensation](#) and remuneration, in part driven by the 3<sup>rd</sup> year of 'Say on Pay' in operation and also by the pervasive [community sentiment](#), not unique to the US, of excessive remuneration, share deals and other overly generous arrangements at the top of the corporate tree.

Reform of board representation, proxy access, annual voting procedures and declassification are showing fruit with a mixture of [governance groups](#), investor coalitions and [large](#) pension funds helping drive changes.

As a positive, active [engagement measures](#) in advance of meetings as well as actual votes are bringing success. On the downside, problems still exist with 'zombie directors' explored elsewhere in this issue and both board tenure and hence opportunities to improve diversity are at best a work in progress.

A welcome development was the [record level](#) of ESG based proposals with climate issues around emissions, energy efficiency and sustainability taking up the lions share. Emissions measurement and reductions, risk assessments and improving overall sustainability reporting were prominent amongst shareholder concerns.

A group of 70 funds formed an [investor coalition](#) to make a coordinated effort in 2014 and both [Exxon](#) and [Shell](#) provided high profile examples that climate and [carbon](#) questions are now mainstream and permanent [investment risk](#) issues for global energy corporations and asset owners.

Even more pleasing was the focus on [political donations](#), coming close behind environmental proposals as a key issue for votes.

The now infamous 'Citizens United' decision of the US Supreme Court has exacerbated an existing situation where corporate political donations and lobbying activities are not matched by transparency, disclosure and shareholder approval for material; levels of expenditure.

PIRC is of the view that good governance is built around shareholder accountability and disclosure. Political activities, direct or indirect should be subject to a level of scrutiny that robustly encompasses both principles.

Human rights particularly labour practices in supply chains also attracted attention from [labour unions](#) and investment activists.

As focus on this issue has a slow but steady momentum at international and national levels.

The increase in virtual meetings, run in tandem with the traditional style is another harbinger of the future.

On the negative side is the continued efforts by [business lobbies](#) to water down [shareholder rights](#) and restrict the operations of proxy advisers.

The intransigence over many reasonable corporate and financial sector reforms and the fierce opposition from some quarters to sensible climate mitigation and adaptation measures is not in the interests of long-term investors and need to be confronted.

Overall, engagement discussions between institutional owners, boards and management on a range of issues are a positive. As is the continued efforts to improve the ability place resolutions before annual meetings.

[SWFs](#) and the [larger national](#) and regional [pension funds](#) in [many countries](#) are now permanent fixtures on global corporate share registers, some with significant direct and indirect holdings. The intermediation of their views by asset managers is changing as many look directly to the corporations they own on behalf of beneficiaries.

In time, more institutional owners will begin to make decisions themselves on board representation, corporate strategy and longer-term risk management.

Some of the resolutions in the 2014 season in the US reflect this trend. The balance is unlikely to tip back the other way.

### Walgreens Reverses on Inversion

#### Domestic pressure sinks tax driven domicile move but BEPS remains a global problem.

Grass roots campaigning and rising political concern over corporate tax dodging has caused Walgreens to reverse its decision to redomicile to Switzerland as part a foreshadowed merger with Alliance Boots. (See PIRC Alerts 22<sup>nd</sup> July 2014).

Walgreens' [announcement](#) came following sustained [opposition](#) by the CTW Investment Group ([CTW](#)), a grass roots campaign coordinated by [Americans For Tax Fairness](#) that saw over 300,000 people [directly petitioning](#) the Walgreens CEO and increasingly critical statements from [Democrats](#), senior Treasury officials and [President Obama](#).

The growing reputational damage and risk to the company's community licence overcame the attraction of a multi-billion dollar tax shuffle with the public controversy providing impetus to [regulatory](#) and [legislative](#) options to make inversion much less attractive for US Corporations.

The debate around inversion has been growing for some years with recent merger activity in the healthcare sector providing high profile [examples](#).

The Washington Post has published a [handy list](#) of many inversions since 1983 noting the gradual shift from the [Caribbean to Europe](#) as Congress played catch up.

Michael Udell from the Washington based [District Economics Group](#) recently released a [detailed policy paper](#) calling for material transparency around the actual sources of domestic versus off-shore sales and profit generation and associated reform of US corporate taxation.

It is one of many options for real reform of US tax rules (and by extension international frameworks) that go further than the simplistic 'cut corporate rates' mantra so beloved of corporate lobbyists everywhere.



At their core all sound proposals for reform have some foundation in improving disclosure and restricting artificial transactions designed primarily to [avoid the intent](#) of existing taxation provisions in national jurisdictions.

As a matter of good governance, institutional investors and asset owners should be active in lobbying governments and international bodies for [greater transparency](#) around actual sources of profits and revenue and reducing the contribution of [questionable artifice](#) as opposed to the creation of sustainable value as an underlying driver of profit.

The Walgreen controversy has been helpful to draw further scrutiny on short term tax driven corporate merger strategies, one part of the wider international debate around Base Erosion and Profit Shifting ([BEPS](#)), on the agenda for consideration at the forthcoming November [G20 Meeting](#) in Brisbane.

Strengthening the sometimes wobbly resolve of national Governments to act, pushing back against the constant [corporate lobbying](#) to water down this round of potential G20 measures is an activity asset owners are uniquely positioned to undertake.

The veil needs lifting on a range of global corporate practices that are primarily focused on 'gaming' the system, legally or otherwise.

Time is running short to shine some brighter light into the darker corners of international tax structures, cross border corporate accounting and questionable governance.

Stiffening the resolve of national governments to act at the G20 should be a taxing the boards of institutional owners as a matter of urgency.

### September

#### Northern Exposure for Rate Riggers

##### **Tiny Alaskan pension fund seeks damages for interest rate swap fixing.**

The [Alaska Electrical Pension Fund](#) (AEPF) has filed a lawsuit accusing 13 of the world's largest banks of conspiring to manipulate the '[ISDAfix](#)' benchmark rate, a daily rate used to price interest rate swaps, derivatives and corporate bonds.

Under question is a depressingly familiar list: Bank of America, Barclays, BNP Paribas, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan Chase, Nomura Holdings, Royal Bank of Scotland, UBS, Wells Fargo UK and broker-dealer ICAP PLC.

The list does not leave out many big names and with assets under management of just \$US1.8billion, the AEPF's case may be seen as David taking on a group of Goliaths.

## Lancashire Quarterly Report

Daniel L. Brockett, the pension fund's lawyer and partner at Quinn Emanuel Urquhart & Sullivan, said the pension fund's claim is 'a good case' and is supported by economic data and empirical evidence.

The pension fund claims that the banks influenced the rates in three ways.

It is alleged they carried out numerous quickly executed transactions just prior to the ISDAfix being set, a practice known as 'banging the close'. Banks also delayed the reporting of rates until after the rate was manipulated and engaged in posting reference rates that did not represent actual trades.

AEPF said that the banks communicated via electronic chat rooms and other means, submitting identical rate quotes from at least 2009. It cites one particular incident when there was a sudden fall in the 10-year interest swap rate only for it to suddenly recover without any clear explanation.

The AEPF's case is seeking to win compensation for members who were affected by the fixing between January 2006 and January 2014 and is the first brought by a private entity.

Reuters reports that the lawsuit was filed less than four hours after U.S. District Judge Denise Cote in Manhattan allowed other investors to pursue a lawsuit accusing 12 banks, most of which were also sued over ISDAfix, of fixing prices in the roughly \$21 trillion credit default swaps market.

The issue is already under investigation by US regulators, including the Commodity Futures Trading Commission, and with many similarities to the LIBOR and the growing Forex rigging scandals, the record breaking fines for banks look set to continue into 2016 on top of the investor legal action just beginning to emerge.

AEPF is a very small Alaskan bear compared to some of the pension fund giants yet to come out of the woods.

## Global

### July

#### **The Name's Bond, Green Bond Market could grow but standards need solidification**

Investor appetite for green bonds is set to grow according to the newly released 2014 [State of the Market report](#) from the pioneering Climate Bonds Initiative (CBI) with support from [HSBC](#). In a comprehensive summary, the report outlines a total universe of bonds linked to climate change solutions at US\$50.6b, outlining the emerging trends and who is investing what and where globally in this nascent asset class.

**Low carbon transport investment, particularly rail projects, make up the lions share with 71% of investment, followed by clean energy at 15% and climate finance at 10%. Buildings and Industry, Agriculture, Waste & Pollution Control and Water make up the remainder to date.**

'Investors are concerned about climate change. This report shows how they can invest in climate bonds without risk. The investment opportunities we find are safe and secure investment grade bonds. This is a Dull Green Market – just how pension funds and insurance funds like it.' Sean Kidney, CEO commented.

'In the coming year we will see growth in labelled Green Bonds from municipalities, cities and corporate issuers. We expect increasing demand from investors signed up to the [Principles for Responsible Investment](#) and the [Global Investor Coalition on Climate Change](#).'

For institutional investors seeking long term opportunities that can incorporate ESG considerations Green Bonds may provide an attractive opportunity.

However investment governance questions still remain. The need for clarity around Guidelines and Standards was the subject of a January editorial in Responsible Investor following the [earlier announcement](#) by major international banks of voluntary [Green Bond Principles](#) 'to encourage transparency, disclosure and integrity in the development of the Green Bond market.'

This [June feature](#) from Keith Mullen at the [International Financing Review](#) discusses many of the due diligence and standards questions that require further development for the market to reach its potential. The issue becomes even more important when set around the headlines foreshadowing a [\\$US1 trillion market](#) in climate bonds and increasing calls to bridge the gap between institutional capital and international assessments of the cumulative trillions of investment needed to hold to a global 2 degree temperature increase.

For its part the Climate Bonds Initiative has been doggedly leading international debate and capital along the bond path, pointing to the requirement for public sector and government support, pushing to create a deeper more liquid market and building its own validation processes in conjunction with the stakeholders who will also be investees. The 'skin in the game' principle was boosted with today's announcement that EUR 44bn Netherlands fund manager ACTIAM had joined Climate Bonds Standard Industry Working Group to help develop green bonds eligibility criteria.

Institutional investors, pension funds and asset managers are increasingly putting their shoulders to the wheel here. The CBI has taken a lead in pointing to the future where ESG requirements more easily merge with investment returns. The issues they highlight may now be taken up and worked through with governments and stakeholders to help create, regulate and accelerate a sustainable climate bonds market.

Building a global, low risk, longer term series of investment opportunities has a wide circle of benefits and seemingly very little downside. It might even help save the planet.

### August

#### Business, Human Rights and Supply Chains

##### **AGM Spotlight on Ralph Lauren is a matter of good governance by investors.**

In a further pointer to the linking of business activity and human rights, US peak labour body, the [AFL-CIO](#), has written to all [Ralph Lauren](#) shareholders seeking approval at the August 7<sup>th</sup> AGM for a Human Rights Risks Assessment Report to be produced by 2015.

The correspondence notes the extensive global supply chain of the fashion house with 'over 700 different manufacturers worldwide' and '98% (by dollar value) of products produced outside the US.' It posits that the company 'is exposed to a variety of human rights risks from its global sourcing of products.'

There is also specific reference to the sourcing of materials from Bangladesh, scene of the Rana Plaza building fire and collapse in Dhaka that resulted in more 3,000 local workers killed and injured, noting that the Company has yet to sign the local [Accord on Fire and Building Safety](#) which has subsequently attracted support from over 150 international retailers and apparel brands.

The Board is opposing the resolution pointing to the company's [Citizenship Report](#) and existing policies and disclosure on human rights and supply chain management as sufficient evidence that the Company is upholding its human rights responsibilities.

The shareholder action is one reflection of a slow but steady trend towards using domestic legal tools to link management of business operations with meeting specific human rights obligations.

At a legislative level, California passed the [Transparency in Supply Chains Act](#) in 2010 and while there remain [implementation problems](#) compliance is growing.

In 2011, the [UN Guiding Principles on Business and Human Rights](#) (UNGP) endorsed by the [Human Rights Council](#) with support from business and NGOs was a momentous step, triggering the revision of other important and related international standards, including the [OECD Guidelines for Multinational Enterprises](#) and the International Finance Corporation's (World Bank) [Performance Standards](#) on Environmental and Social Sustainability.

In April, the European Parliament adopted a [non-financial reporting directive](#), which includes [human rights](#) reporting and will have impacts for disclosure at the Member State level.

The UK Companies Act [Regulations 2013 \(Section 414C \(7\) \(b\) \(iii\)\)](#) also calls for reporting on human rights issues in strategic reports.

The [Modern Day Slavery Bill](#), [currently before parliament](#), may have some [deficiencies around disclosure](#) but is a further example of important development at a nation state level relating to business and [human rights](#).

June 2014 saw the Human Rights Council establishing a new [inter-Governmental working group](#) to develop “*an international legally binding instrument on transnational corporations and other business enterprises with respect to human rights*.”

Progress is inevitably slow with these agendas, but movement towards a legally binding instrument in this area at the international level is not insignificant.

Institutional investors and pension funds must develop knowledge and understanding of how human rights violations affect not only reputational profiles of their portfolio companies but matters of value too.

Investor understanding can be achieved. Supply chain disclosure around carbon emissions and wider aspects of climate risk are now mainstream and a must. Those companies resisting transparency will eventually become the ugly ducklings of most indices.

[Water resourcing](#) and [agricultural resilience](#) are next in line for attention.

Not far behind is the embedding of the UN [Guiding Principles](#) via various domestic standards and legislation and longer term potential for international law to be strengthened via a treaty.

In one sense, the AFL-CIO resolution is one minor straw in the wind, in another, part of a much wider expectation from a broad and varied community of stakeholders.

From start to finish in their supply chains companies are increasingly being held accountable for human rights abuses in far away places as the [recent example](#) involving UK supermarket chains and prawns sourced from Thailand [demonstrates](#).

Asking questions now, adding human rights violations to the business risks that need exposure, disclosure and consideration is another area of good governance practice for investors, that may well be a legal requirement in the not to distant future.

Being ahead of that game is crucial.

### **Columbia steps up on Sustainability**

#### **Second Latin American exchange to join SSE Initiative, bigger indexes are still slow to move.**

The Columbian Securities Exchange (BVC) the fourth largest in South America will partner with the Sustainable Stock Exchanges Initiative (SSE) becoming the second Latin index behind Brazil sign up to the UN Initiative.

The decision follows the LSE Group's SSE announcement in early June that saw the No11 Exchange in the world add its weight to pressure for improved ESG standards and disclosure.

Other Initiative members include India, South Africa, the NYSE Euronext and NASDAQ.

'BVC recognizes the relevance of sustainability for the private sector, which is why it has proposed raising initiatives to foster the knowledge and skills needed in the market to face the challenges of sustainable and responsible investment. All this, with the vision set on creating long-term value for the prosperity of Colombia and the region.' BVC CEO Juan Pablo Córdoba in making the announcement

The BVC has previously taken initial steps down the ESG path, joining with leading ESG research firm Sustainalytics and Deloitte to form the Latin American Sustainable Investment Forum (LatinSIF) in 2012 to help build responsible investment networks in the region.

More recently, the Forum has been coordinating a range of cross border investor engagement activities with the Principles for Responsible Investment (PRI).

The Exchange has also commissioned and released a wide-ranging report from Sustainalytics on the state of responsible investing across Latin American markets.

Though backed by a group of global sustainability heavyweights including the UN Finance Initiative UNCTAD and the PRI, the SSE has yet to reach critical mass across international exchanges.

Progress to date and expansion plans are to set be discussed at the Global Dialogue 2014 a part of the World Investment Forum in October.

As a 2013 Benchmarking Report into sustainability disclosure on world exchanges demonstrated, there is space for significant improvement.

PIRC looks forward to further announcements as other bourses follow the lead Columbia, Brazil, London and others have shown.

## September

### Tax Reform Focus as G20 Approaches

#### Transparency and disclosure around global tax and financial secrecy appears on investor radar

Institutional investor attention is finally turning to Base Erosion and Profit Shifting (BEPS) in the run up to the November G20 Summit in Brisbane, Australia.

While corporate opposition to the OECD agenda and Action Plan has been constant, many investor voices have yet to be as outspoken in supporting improved transparency and disclosure as a part of the reform agenda for the world's ramshackle international tax system. Some investors particularly in the US feel conflicted, preferring their government to make the running.

The €16billion Finnish state based pension fund VER thinks more could be done. A May report by corporate responsibility watchdog Finnwatch found that at least €37 billion out of an estimated €160 billion overall of Finnish pension funds' assets were invested in tax havens via registered investment funds.

Favoured tax shelters included Luxembourg, Ireland and Cayman Islands.

Based on the findings of this report, it is probable that the investments of pension providers and pension funds have been used in aggressive tax planning contrary with the purposes of tax laws at various points in the investment chain,' VER RI manager Tiina Tarma, told Citywide in late August.

'The discussion going on within the ESG/SRI theme is whether it should include tax issues so that investors receive information regarding transparency. This debate has arisen in response to a number of high profile cases of tax avoidance from large corporations.'

'Pension investors should add taxation to their responsibility policies and adopt tools for responsible investors to ensure responsible payment of taxes throughout the entire investment chain,' Tarma said.

Leading global ESG group Principles For Responsible Investment (PRI) has also added a view to the mix in the lead up to the Summit.

Writing in Pensions and Investments Online chief executive Fiona Reynolds has urged international companies to pay their fair share of taxes, pointing to the reputational, legal and financial risks of aggressive tax strategies.

'Investors are starting to focus on tax strategy as a material risk; many PRI signatories are engaging with companies on the issue. Engagement on tax is at an early stage.'

'In most cases, investors are simply seeking to better understand management's approach to tax planning and its impact on other business decisions,' she says.

A May report from UK based NGO Christian Aid revealed that FTSE 100 companies had over time created 29,891 subsidiaries with no public information available on over 20% of them.

The FTSE 100 sectors with most subsidiaries in highly secretive tax havens as defined by the Financial Secrecy Index were investment and finance with 37 per cent of their subsidiaries in such locations, banks on 28 per cent, mining companies at 19 per cent and real estate at 18 per cent.

'What our findings show is that secrecy is not the exception but the norm, even among the largest 100 companies whose shares are traded on the London Stock Exchange, 'Katherine Teague co-author of the report said.

'These are household-name firms in which millions of people invest, through their pension funds and savings. But the secrecy is so deep and widespread that it is like a blindfold on everyone who has financial dealings with these companies.'



Amongst the OECD BEPS initiatives are measures to shine some light on banking secrecy in tax matters, announcing plans for a '[Global Standard](#)' on automatic exchange of financial information, set to be presented to G20 Finance ministers at their preliminary meeting in late September prior to the November Summit.

But is it enough? Oxfam in their [Business Amongst Friends](#) report of May 2014 noted the force of corporate lobbying with the OECD had already influenced the dropping of a number of key measures to promote increased transparency and disclosure in the reform proposals.

A new paper entitled '[Public Pressure and Corporate Tax Behaviour](#)' authored by US academics reinforces the view that pressure for disclosure can force a change in corporate taxation strategies and Australia's Lowy Institute has a similar approach, calling for [greater weight](#) to be placed on the power of transparency in preventing excessively aggressive corporate tax minimisation strategies.

At an institutional investor level, the debate over taxation reform is inextricably linked to the deeper issue of future global financial stability including 'too big to fail' and issues around systemic financial system risk.

Banking and corporate secrecy, opaque arrangements and a focus on aggressive tax avoidance strategies does little to lesson this systemic risk.

In the run up to the G20 a simple question needs to be asked of transnational companies, tax havens, big banks and the large audit firms:

'What have you got to hide and why?'

September

### **OECD outlines next steps in BEPS Battle**

#### **G20 Finance Ministers to consider new rules ahead of Brisbane Summit.**

The OECD [has unveiled](#) a range of reform measures to international taxation rules that will be presented to Finance Ministers meeting in Australia on the 20<sup>th</sup>-21<sup>st</sup> of September as a precursor to the Leaders summit in late November.

Progress has been made on [seven elements](#) of the OECD 15 Point [Action Plan](#) of 2013 including measures to address arbitrage, opacity, treaty shopping and improve corporate reporting. In-principle agreement has been reached with 44 countries representing the overwhelming majority of the world economy.

According to today's [announcement](#) by OECD Secretary-General Angel Gurría:

'Tax evasion and avoidance have been depriving our governments of precious resources for decades. In the past years, our governments have been struggling to find the resources to jumpstart growth, to exit the crisis and to promote more and better jobs, while base erosion and profit shifting practices weakened these efforts. I am delighted to announce the beginning of the end of these corrosive practices.'

The first 7 elements of the Action Plan, [released](#) in Paris today focus on helping countries to:

- ensure the coherence of corporate income taxation at the international level, through new model tax and treaty provisions to neutralise [hybrid mismatch arrangements](#) (Action 2);
- realign taxation and relevant substance to restore the intended benefits of international standards and to [prevent the abuse of tax treaties](#) (Action 6);
- assure that transfer pricing outcomes are in line with value creation, through actions to address [transfer pricing issues in the key area of intangibles](#) (Action 8);
- improve transparency for tax administrations and increase certainty and predictability for taxpayers through improved [transfer pricing documentation and a template for country-by-country reporting](#) (Action 13);
- address the [challenges of the digital economy](#) (Action 1);
- facilitate swift implementation of the BEPS actions through a report on the [feasibility of developing a multilateral instrument](#) to amend bilateral tax treaties (Action 15); and
- counter [harmful tax practices](#) (Action 5).'

A handy 3 minute [YouTube clip](#) is also available as an [alternative](#) to the background [OECD reports](#) on Base Erosion and Profit Shifting.

While PIRC welcomes any progress on global financial reform, implementation remains a key weakness with legislative and regulatory change required by domestic jurisdictions and amendments to various tax treaties.

However, sceptics will note the corporate supporters of inertia and the status quo particularly those in the US have shown a remarkable ability over the last decade to derail various initiatives and lobby national governments to defer or delay action.

The OECD announcement diplomatically intimates some of the obstacles that still lie ahead:

'These recommendations may be impacted by decisions taken with respect to the remaining elements of the BEPS Action Plan, which are scheduled to be presented to G20 Governments for final approval in 2015. At that point Governments will also address implementation measures for the Action Plan as a whole.'

Whilst these announcements are a step, actual implementation of tangible reforms, transparency measures and credible disclosure is another. There are significant parts of the Action Plan still to be resolved.

We will keep the bubbly on ice for the time being.

### **Sustainability outperforms**

#### **Sustainability and performance go hand-in-hand.**

A seminal new paper reviewing the analysis of over 190 studies of sustainability and its relationship with corporate performance has concluded that there is 'remarkable correlation' between the two factors.

The meta-study titled, [From the Stockholder to the Stakeholder](#) is co-authored by the [Smith School of Enterprise and the Environment](#), part of the University of Oxford, and [Arabesque Asset Management](#).

With debate intensifying over the ongoing links between sustainability and long term performance, [the report](#) attempts to bring together previous research on the subject. It concludes that the majority of studies find that implementing sustainability practices improve performance in both an operational sense and in overall investment performance.

The eight main highlights of the report are as follows:

- Sustainability is one of the most significant trends in financial markets for decades.
- The report represents the most comprehensive knowledge base on sustainability to date, based on more than 190 academic studies, industry reports, articles, and books.
- 90% of the studies on the cost of capital show that sound sustainability standards lower the cost of capital of companies.
- 88% of the research shows that solid ESG practices result in better operational performance of firms.
- 80% of the studies show that stock price performance of companies is positively influenced by good sustainability practices.
- Based on the economic impact, it is in the best interest of investors and corporate managers to incorporate sustainability considerations into their decision making processes.

- Active ownership allows investors to influence corporate behaviour and benefit from improvements in sustainable business practices.
- The future of sustainable investing is likely to be active ownership by multiple stakeholder groups including investors and consumers.

One of the more salient points made is the role that beneficiaries of pension funds can play, that it is in their interest to push companies to act more responsibly so that they generate better returns for savings and pensions as well as preserving the state of the world.

‘Active ownership is a powerful tool. However, in its current form, it lacks the structural support of a key stakeholder group: the customer of the invested companies. The future of active ownership will most likely be one where multiple stakeholders such as individual investors and consumers are involved in setting the agenda for the active ownership strategy of institutional investors’ it concludes.

The pain of short termism, excessive risk taking, and ignoring externalities has been felt by both institutional investors and their beneficiaries via the global financial crisis.

Forward-looking pension funds are now seeking more influence in their desire for long-term value creation. Civil society also sees corporate transparency, disclosure and higher ethical standards as implicit in the licence to operate.

Companies who believe sustainability, ESG & social expectations can be ameliorated in the short term miss the point.

The long term is here, ready or not.

## Asia

### July

#### ACSI Pushes on Sustainability Risks

##### Australia's top 250 companies subject to scrutiny and new regulations.

The influential Australian Council of Superannuation Investors ([ACSI](#)) has just released its seventh report on [Sustainability Risk Disclosure Among ASX 200](#) companies.

The ACSI research reveals that 40% of the ASX 200 remain rated in the lowest categories of disclosure in a five level system, a somewhat disappointing result despite an overall positive trend.

On the positive side, 85% of companies provided some level of reporting on sustainability factors and almost 50% provided a response to the Carbon Disclosure Project ([CDP](#)) with 85% of those companies subsequently disclosing their responses.

“Investors, such as ACSI’s members, need meaningful, accurate, timely and comparable data to help them identify and manage their exposure to ESG investment risks as they make decisions about selection and weighting of stocks in their portfolios. This information is also a crucial input into investors’ processes for engaging with companies and exercising their ownership rights,” CEO Gordon Haggert said.

In recent years, pressure has been slowly rising on corporate Australia to improve risk assessment and disclosure of ESG related issues. ACSI produced its first report in 2008 covering the ASX 100 and subsequently expanded its scope in 2009.

In 2011, ACSI and the Financial Services Council ([FSC](#)) the peak body for asset managers and retail investor organisations released a joint [ESG Reporting Guide](#) for Australian companies.

In [March 2013](#) the corporate regulator [ASIC](#) released its [Regulatory Guide 247](#) which amongst other governance changes required company annual reports ‘include a discussion of environmental and other sustainability risks where those risks could affect the entity’s achievement of its financial performance or outcomes disclosed, taking into account the nature and business of the entity and its business strategy.’

New Australian Stock Exchange ([ASX](#)) guidelines applying from July 2014 recommend companies consider [sustainability risks](#) under revised [Corporate Governance Principles](#). The ASX proposes that “a listed entity should disclose whether and if so how, it has regard to economic, environmental and social sustainability risks.” However the requirement is not mandatory, operating on an ‘if not-why not basis.’

ACSI, backed by many of Australia largest mutual based pension funds has been slowly toughening its policy in this area, adopting a name and shame approach to corporate laggards.

While the combination of changes moves Australia closer to some international standards this latest report shows more work is needed.

Australia is now the [12<sup>th</sup> largest](#) economy in the world. Though still dwarfed by the majors, it is the single largest exporter of coal and iron ore and a major resources and energy supplier. Banking, resources and media stocks dominate the local exchange.

The Towers Watson [Global Pensions Asset Study 2014](#), reports Australian pension assets as the 4<sup>th</sup> largest in the world at \$US1.6t, experience high growth rates thanks to the system of [compulsory employer pension contributions](#) currently set at 9.5% and legislated to reach 12% over the next decade.

With Australian pension funds having a [comparatively high level](#) of exposure to domestic and global equities and a rising inflow, investment risk management, particularly around current and future sustainability questions should remain high on the governance agenda.

The decision by the new Australian government to repeal domestic carbon pricing has brought undone one economy wide partial hedge against asset mispricing risk, will slow general adaptation measures and removes an underlying incentive for companies to lift their internal level of analysis.

ACSI has foreshadowed it will continue to name and shame companies that are lagging in sustainability disclosure. Will this be enough to push the existing 40% of slow movers further up the ladder?

The level of preparedness of the huge, fast growing mutual funds that are the primary backers of ACSI to make good the ASIC and ASX changes direct with local companies and asset managers will become even more integral to improving local and ultimately international ESG standards.

### Shareholders stall remuneration bid at Tata

#### India's leading car manufacturer sees executive pay resolutions rejected and share price improve

Shareholders of India's largest carmaker, [Tata Motors](#) have rejected the excess compensation arrangements for three of its directors via a postal ballot.

Tata had been required to obtain [shareholder approval](#) for the increases due to inadequacy of profits following a trading loss for the year-end March 31<sup>st</sup> 2014. Corporate law changes from last year limit remuneration paid to 'whole-time' directors is more than five percent of net income if profit is low or non-existent. In Tata's case of no profits, it may pay up to 4.8 million rupees with any excess needing to be approved by shareholders.

In a [notice](#) to the Bombay Stock Exchange ([BSE](#)) Tata advised it failed to reach the 75 percent threshold needed to pass the special resolutions which concerned the remuneration of two senior executives and beneficiaries of the late Managing Director Karl Slym

As payments were made prior to the shareholder vote the embarrassing prospect of returning the funds arises.

Almost 30 percent of shareholders voted against the resolutions with over 64 percent of the key institutional investors who own 37 percent of the company voting against.

Markets initially reacted well with the company's shares rising 3.03 percent upon the news.

The development has wider ramifications, Anil Singhvi from [Institutional Investor Advisory Services](#), a leading shareholder advisory firm told the [India Times](#) following the result: "The event at Tata Motors should not be taken as an event of a company having lost three resolutions, but as a major event for all corporates in India to not take shareholders votes at AGMs for granted. The resolutions which were put to vote and defeated in Tata Motors were hitherto considered ordinary business by the board of directors, to be left to the company secretary to prepare the notice of the AGM and obtain the vote."

Indian proxy advisory service [InGovern](#) said, "Companies should recognize that minority investors are increasingly assertive on company matters and companies should, in the interest of good corporate governance, take the views of these investors into account when putting forth various proposals."

"The company takes cognisance of the shareholders' views; at the same time, it is necessary to balance this with recruiting and retaining an industry-proven management team through the long-term.' A spokesperson [told Reuters](#).

### Australia Reins in Exec Pay

#### Legislation with teeth puts the bite on excessive payments and builds shareholder engagement

The annual survey by the influential Australian Council of Superannuation Investors ([ACSI](#)) details some impressive figures in the battle to rein in excessive 'golden parachutes' and overall executive remuneration.

The [13<sup>th</sup> Annual ACSI Survey of Chief Executive Remuneration](#) reveals that termination payments have shrunk by nearly 70% in the past five years with the median payment to chief executives falling to A\$1.3m in 2013, from A\$35 m in 2008.

Average statutory pay for CEOs at \$A4.84m is still high at sixty times average weekly earnings (AWE) but is at its lowest level in a decade and 33% below the 2007 peak of ninety times AWE.

ACSI chief executive, Gordon Hagart, said the study findings showed the [benefit of investor scrutiny](#): 'When investors behave like owners, and make it clear to boards their expectations around executive pay, Australian boards generally respond.'

Australia's groundbreaking 'Two Strikes' legislation of 2009, now in its third year of operation at public company AGMs is the platform being used to more closely align shareholder interests with remuneration. However the story of how Australia adopted such an active corporate governance measure starts at the tail end of the 1990s.

Executive salaries took off in Australia following the 1998 appointment of American Paul Anderson as first foreign head of the iconic BHP, Australia's premier blue chip company, dominant in minerals, oil & gas, iron & steel & a host of associated subsidiaries.

The new tone became evident when BHP made a record A\$11.1million redundancy payment to Andersons predecessor, John Prescott, sparking criticism from local unions who highlighted BHP's A\$1.47billion operating loss for the 1997-98 year.

Undaunted, the Board set Anderson's starting salary package at around two hundred times AWE, a jump from BHP's previous standard of less than 50 times earnings, all helpfully plotted in a seminal study of 110 years of BHP remuneration by Labour [MP Andrew Leigh](#).

This very public move by the 'Big Australian' sharply accelerated the previous slow rise in executive and director fees that had emerged in the early 90s.

Anderson's starting salary stirred a measure of public comment and he was dubbed the [\\$8 Million Dollar Man](#) by BHP's largest union pre-arrival in 1998 and then more derisively labelled on departure as the [\\$17 Million Dollar Man](#) a reflection on the overall value of his termination payment as BHP merged with Billiton in 2002 to create a global resources behemoth.

By then, the floodgates had opened. The example BHP had set was swiftly replicated. CEO salaries sat around fifty five times AWE in 2001 and lifted to sixty nine times by 2004.

To deflect rising community concern and nascent pressure from some institutional shareholders the then government introduced a shareholder advisory vote on remuneration in 2004 and additional disclosure as part of the '[CLERP 9](#)' overhaul to corporate law. Australia business leaders responded in kind with CEO base pay increasing to eighty one times AWE by 2006, peaking at ninety four times AWE in 2007. The global financial crisis engendered some moderation with base pay slipping back to a relatively meagre 84 times by 2008.



The 2007 change of Government heralded the next stage of legislative reform. New [Legislation](#) in 2009 significantly expanded the scope and criteria for shareholder approval of termination pay was passed in the face of [vociferous opposition](#) from the business sector and [lobby groups](#).

Following an extensive enquiry by the independent [Productivity Commission](#) 2011 then saw the passage of the now infamous '[Two Strikes](#)' rule. In simple terms if a remuneration report received a no vote of 25% or more at two consecutive AGMS companies were required to put a motion to 'spill' (enforced re-election) of the entire board at the 2<sup>nd</sup> meeting.

Again, business condemned the changes with one senior corporate leader making the [risible suggestion](#) that investors should simply exit equity market holdings if they didn't agree with board determinations on remuneration.

The 2011 legislation should have come as no surprise. Executive pay had been a contested and controversial issue in Australia for well over a decade and ACSI, backed by the nation's mutual based industry superannuation (pension) funds has taken an [active role](#) on remuneration [issues](#).

The mutual pension funds provided a base of votes at AGMs where remuneration was deemed excessive and with ACSI, engaged more actively with asset managers on governance matters matching their growing size and sophistication.

A change of government in 2007 was pivotal in giving impetus to reform. The administration was elected with an explicit policy position to give shareholders a greater say on executive remuneration, a corporate governance issue that had long moved from the business sections of newspapers into the mainstream with widespread public recognition and support.

Corporate Australia, in opposing both the 2004, 2009 and 2011 laws had consistently occupied a fundamentally conflicted position. The domestic captains of industry and commerce had spent the last 15 years repeatedly advocating wholesale deregulation of industrial relations and workplace laws.

Simultaneously, vigorously opposing regulation or greater shareholder influence on remuneration structures and defending [huge increases](#) in executive pay arrangements and [director fees](#) often unrelated to financial performance.

Public opinion was behind the Government on the 2009 and 2011 legislation and three years on the results are both measurable and positive.

Business warnings of an exodus of executives and directors to off-shore roles have not been realised, nor have the wild predictions that giving shareholders a lower threshold and a direct say on remuneration would render boards unstable, AGMs unmanageable and senior roles unfilled.

Australian law contrasts with the US Dodd-Frank Act that gives an advisory vote to shareholders with 'say on pay' at publicly listed companies with additional reporting and the UK legislation, applying from October 2013, requiring more disclosure and a watered down binding vote process.

ACSI CEO Gordon Haggert [characterised](#) the gradual shift in these terms:

'ACSI observes that increased investor engagement, combined with the work of more active boards, has resulted in better remuneration packages that improve alignment between executives and the providers of capital. We have seen fewer votes against remuneration reports over the past year as remuneration packages have improved in the market.'

'Specific improvements include the major reduction in termination payments, more demanding bonus hurdles, longer performance measurement periods and an end to the culture where bonuses were seen as entitlement rather than reward for outperformance.'

Notwithstanding executive pay in Australia is still excessive, from a governance perspective, the say on termination provisions and three years of direct shareholder votes have seen the beginning of a much deeper process to gradually re-align remuneration with institutional and asset owner interests of sustainable long term value creation.

The voting reforms have been effective in driving greater engagement between boards, asset owners, managers and proxy advisers.

Ian Woods Head of Governance at AMP Capital bluntly [puts it this way](#) 'Five years ago, the chairs wouldn't return my calls about the remuneration report, today they are calling me.'

### SSE Initiative Gains Toehold in Asia

#### Thai Exchange Joins Sustainable Stock Exchange Network with commitment to promoting sustainable development

The Stock Exchange of Thailand ([SET](#)) [has joined](#) 12 other leading exchanges in signing up to the [SSE Initiative](#).

'To be the first exchange in ASEAN joining the SSE initiative reinforces our regional leadership and will enhance SET international recognition. SET Chair [Sathit Limpongpan](#) said, 'This follows SET's currently remarkable sustainable development in the region, proven records by achieving the top ASEAN corporate governance score for two years in a row (2013-2014), being Asia's top score of Corporate Governance – [Report](#) on the Observance of Standards and Codes, as [assessed by](#) the World Bank. We therefore welcome this initiative as it will allow us to share and learn the best practice with other exchanges.'

SET President [Kesara Manthusree](#) said that ‘The Thai bourse has created its own sustainability development framework, aiming to enhance all dimensions of quality towards sustainability of the Thai capital market, economy, society, and environment. It would focus on five key areas, namely market value, business operations, employees, society, and environment. SET would soon establish a working group to substantially construct short, medium and long-term plans for these five key areas.’

The announcement follows the Columbian Securities Exchange ([BVC](#)) [announcement](#) of July 2014 and the June LSE Group [decision](#) to partner with the SSE.

The Thai decision adds further momentum for the SSE Initiative, initially launched in 2009, which has successfully built engagement with 12 stock exchanges worldwide and is backed by a group of global sustainability heavyweights including [UNCTAD](#), the [UN Finance Initiative](#) and the Principles for Responsible Investment ([PRI](#)).

## Japan

### Third Arrow Strikes

#### Abe announces plans to introduce corporate governance code

The Japanese government formally announced plans to launch a new corporate governance [code](#) as part of its [Revitalisation Strategy](#).

The announcement was made live on television as part of Prime Minister Shinzo Abe's 'third arrow' of reforms to improve the Japanese economy through a series of measures to stimulate growth, shake up the moribund economy and open a stultified business culture. (See PIRC Alerts 24/07 and 22/01)

The code is to be developed by the Tokyo Stock Exchange and is expected to take effect next year. In a similar vein to many corporate governance practices worldwide, it will operate on a 'comply or explain' basis. Coupled with the newly introduced [Stewardship Code](#) it may help achieve the improved governance standards that both Abe and many foreign investors are looking for.

"We want to establish this code because we believe lean, energetic and healthy companies are going to restore Japan's competitiveness," said Yasuhisa Shiozaki, a Liberal Democrat Party lawmaker.

[One focus](#) is on increasing the number of non-executive directors in local companies. Historically, Japanese boards have had few if any independent directors and poor levels shareholder engagement and disclosure.

However, this has not been met positively by all. The peak business lobby Keidanren, has opposed the idea with managing director, Yasuhisa Abe stating "There is absolutely no basis for the argument that companies with outside directors perform better."

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PIRC LTD

## **LANCASHIRE PENSION FUND**

### **PROXY VOTING REVIEW**

PERIOD: 1<sup>st</sup> JANUARY 2014 TO 30<sup>th</sup> SEPTEMBER 2014

.....



**CLIENT:** Lancashire Pension Fund

**PROJECT TITLE:** Proxy Voting Review

**DATE:** 05<sup>th</sup> November 2014

**1. RESOLUTIONS ANALYSIS**

- a. Number of resolutions voted: 4001 (note that it includes non-voting items).
- b. Number of resolutions opposed by client: 945

**2. NUMBER OF RESOLUTIONS BY VOTE CATEGORIES**

Table 1: Vote Categories

VOTE CATEGORIES	NUMBER OF RESOLUTIONS
For	2475
Abstain	252
Oppose	945
Non-Voting	108
Not Supported	4
Withhold	215
US Frequency Vote on Pay	2
<b>TOTAL</b>	<b>4001</b>

**3. VOTE BREAKDOWN BY REGION**

Table 2: Vote Categories by Region

REGION	FOR	ABSTAIN	OPPOSE	NON-VOTING	NOT SUPPORTED	WITHHOLD	US FREQUENCY VOTE ON PAY
UK	383	35	55				
Europe & Global EU	731	85	274	104	4		
USA & Canada	947	99	469			215	2
Asia	96	24	57	3			
Japan	265	1	28				
Australia/ South Africa	27	7	39	1			
South America	9		6				
Rest Of The World	17	1	17				
<b>TOTAL</b>	<b>2475</b>	<b>252</b>	<b>945</b>	<b>109</b>	<b>4</b>	<b>215</b>	<b>2</b>

#### 4. VOTE RECOMMENDATION WHERE RESOLUTIONS HAVE PASSED

Table 3: Top 20 resolutions which received the highest percentage Oppose/Abstain vote

COMPANY NAME	PROPOSAL	VOTE	OPPOSE%
Total Sa	Shareholder Resolution: Approve Appointment of Employee Representatives to the Board Committees and Amend Article 12.5 of Bylaws	Oppose	97.00%
Total Sa	Shareholder Resolution: Allow Loyalty Dividends to Long-Term Registered Shareholders and Amend Article 20 of Bylaws	Oppose	96.16%
Pfizer Inc.	Shareholder Resolution: Approval of political contributions policy	Abstain	92.46%
Total Sa	Shareholder Resolution: Amend Board Internal Rules Re: Publication of a Quarterly Newsletter Written by Employee Shareholder Representatives	Abstain	83.21%
Entergy Corp.	Shareholder Resolution: Decommissioning of Indian Point Nuclear Reactors.	Oppose	82.70%
Schindler Holding Ag	Approve the Remuneration of the Board of Directors	Abstain	82.39%
American Express Co	Shareholder Resolution: Executives to retain significant stock	Abstain	79.12%
Union Pacific Corp.	Shareholder Resolution: Executives to retain significant stock	Abstain	74.30%
Bank Of America Corp.	Shareholder Resolution: Introduce cumulative voting	Oppose	74.11%
FedEx Corporation	Shareholder Resolution: Hedging and pledging policy	Abstain	73.82%
Centurylink Inc	Shareholder Resolution: Equity retention	Abstain	72.61%
Honeywell International Inc.	Shareholder Resolution: Eliminate Accelerated Vesting In A Change In Control	Abstain	70.93%
Becton Dickinson & Co	Approval of material terms of performance goals under Performance Incentive Plan	Oppose	69.52%
L-3 Communications Holdings Inc	Shareholder Resolution: Equity retention by senior executives	Abstain	69.31%
Verizon Communications Inc	Shareholder Resolution: Network Neutrality	Abstain	67.92%
General Motors Co	Shareholder Resolution: Cumulative Voting	Oppose	63.64%
New York Community Bancorp Inc	Approve Executive Compensation	Oppose	52.67%
Schindler Holding Ag	Approve the remuneration of the Group Executive Committee	Abstain	49.87%
Total Sa	Re-elect Paul Desmarais Jr	Oppose	49.56%
AT&T Inc.	Advisory vote on Executive compensation	Abstain	43.74%
AstraZeneca Plc	Elect Jean-Philippe Courtois	Abstain	42.61%
Vector Group Ltd	Advisory vote on executive compensation	Oppose	38.48%
Live Nation Entertainment	Approve Executive Compensation	Oppose	37.69%
Tesla Motors Inc	Amend Omnibus Stock Plan	Oppose	33.87%
Novartis Ag	Elect Ulrich Lehner as a member of the Compensation Committee	Oppose	33.08%
SAP Ag	Re-elect Wilhelm Haarmann	Oppose	32.38%
Terna - Rete Elettrica Nazionale Spa	Approve the Remuneration Report	Oppose	31.22%
Muenchener Rueck Ag	Re-elect Wolfgang Mayrhuber	Oppose	30.08%
HCP Inc	Approve Pay Structure	Oppose	30.05%
Live Nation Entertainment	Elect Gregory B. Maffei	Oppose	29.78%

Table 4: Top 20 UK resolutions which received the highest percentage Oppose/Abstain vote

COMPANY NAME	PROPOSAL	VOTE	OPPOSE%
AstraZeneca Plc	Elect Jean-Philippe Courtois	Abstain	42.61%
Reckitt Benckiser Group Plc	Approve Remuneration Policy	Oppose	19.34%
AstraZeneca Plc	Approve Remuneration Policy	Oppose	12.23%
Imperial Tobacco Group Plc	Approve Remuneration Policy	Oppose	11.85%
AstraZeneca Plc	Elect Marcus Wallenberg	Abstain	10.70%
British American Tobacco Plc	Approve Remuneration Policy	Oppose	9.44%
Tullow Oil Plc	Approve Remuneration Policy	Oppose	9.19%
Prudential Plc	Approve Remuneration Policy	Oppose	7.95%
Greene King Plc	To re-elect Tim Bridge	Oppose	7.18%
BAE Systems Plc	Approve Remuneration Policy	Oppose	6.99%
BAE Systems Plc	Approve new long term incentive plan	Oppose	6.46%
AstraZeneca Plc	Approve the 2014 Performance Share Plan	Oppose	6.29%
Reed Elsevier Plc	Approve Remuneration Policy	Oppose	6.00%
Rolls-Royce Holdings Plc	Approve the Remuneration Report	Abstain	5.78%
Reckitt Benckiser Group Plc	Re-elect Adrian Bellamy	Oppose	4.68%
Greene King Plc	Approve Remuneration Policy	Oppose	4.11%
GlaxoSmithKline Plc	Re-elect Sir Christopher Gent	Oppose	4.09%
Bunzl Plc	To re-elect Mr P G Rogerson	Oppose	4.03%
WH Smith Plc	Approve the Remuneration Report	Oppose	4.02%
Rolls-Royce Holdings Plc	To approve the Performance Share Plan (PSP)	Oppose	3.89%

Table 5: Top 20 US & Canadian resolutions which received the highest percentage Oppose/Abstain vote

COMPANY NAME	PROPOSAL	VOTE	OPPOSE%
Pfizer Inc.	Shareholder Resolution: Approval of political contributions policy	Abstain	92.46%
Entergy Corp.	Shareholder Resolution: Decommissioning of Indian Point Nuclear Reactors.	Oppose	82.70%
American Express Co	Shareholder Resolution: Executives to retain significant stock	Abstain	79.12%
Union Pacific Corp.	Shareholder Resolution: executives to retain significant stock if properly presented at the Annual Meeting.	Abstain	74.30%
Bank Of America Corp.	Shareholder Resolution: Introduce cumulative voting	Oppose	74.11%
FedEx Corporation	Shareholder Resolution: Hedging and pledging policy	Abstain	73.82%
Centurylink Inc	Shareholder Resolution: Equity Retention	Abstain	72.61%
Honeywell International Inc.	Shareholder Resolution: Eliminate Accelerated Vesting In A Change In Control	Abstain	70.93%
Becton Dickinson & Co	Approval of material terms of performance goals under Performance Incentive Plan	Oppose	69.52%
L-3 Communications Holdings Inc	Shareholder Resolution: Equity retention by senior executives.	Abstain	69.31%
Verizon Communications Inc	Shareholder Resolution: Network Neutrality	Abstain	67.92%
General Motors Co	Shareholder Resolution: Cumulative Voting	Oppose	63.69%
New York Community Bancorp Inc	Approve Executive Compensation	Oppose	52.67%
AT&T Inc.	Advisory vote on Executive compensation	Abstain	43.74%
Vector Group Ltd	Advisory vote on executive compensation	Oppose	38.48%
Live Nation Entertainment	Approve Executive Compensation	Oppose	37.69%
Tesla Motors Inc	Amend Omnibus Stock Plan	Oppose	33.87%
HCP Inc	Advisory vote on executive compensation	Oppose	30.05%
Live Nation Entertainment	Elect Gregory B. Maffei	Oppose	29.78%
Applied Materials Inc	Advisory vote on executive compensation relating to the Business Combination.	Oppose	27.23%

Table 6: Top 20 US & Canadian resolutions excluding shareholder proposals which received the highest percentage Oppose/Abstain vote

COMPANY NAME	PROPOSAL	VOTE	OPPOSE%
Becton Dickinson & Co	Approval of material terms of performance goals under Performance Incentive Plan	Oppose	69.52%
New York Community Bancorp Inc	Approve Executive Compensation	Oppose	52.67%
AT&T Inc.	Advisory vote on Executive compensation	Abstain	43.74%
Vector Group Ltd	Approve Pay Structure	Oppose	38.48%
Live Nation Entertainment	Approve Executive Compensation	Oppose	37.69%
Tesla Motors Inc	Amend Omnibus Stock Plan	Oppose	33.87%
HCP Inc	Advisory vote on executive compensation	Oppose	30.05%
Live Nation Entertainment	Elect Gregory B. Maffei	Oppose	29.78%
Applied Materials Inc	Advisory vote on executive compensation relating to the Business Combination.	Oppose	27.23%
Seattle Genetics Inc	Amend existing long term incentive plan	Oppose	26.94%
Ultra Petroleum Corp	Approve new Omnibus plan	Oppose	26.04%
Intuit Inc.	Approval of the Amended and Restated 2005 Equity Incentive Plan	Oppose	24.12%
Raytheon Co.	Re-elect Linda G. Stuntz	Oppose	23.31%
Entergy Corp.	Advisory vote on executive compensation	Abstain	21.00%
Philip Morris International Inc.	Elect Sergio Marchionne	Abstain	20.45%
Wisconsin Energy Corp.	Advisory vote on executive compensation	Oppose	19.73%
People's United Financial Inc.	Approve the Long-Term Incentive Plan.	Oppose	19.39%
Walt Disney Co.	Advisory vote on Executive Compensation	Oppose	19.30%
Bank Of New York Mellon Corp.	Amend existing long term incentive plan	Oppose	19.282%
The Travelers Co's.	Non-Binding Vote on Executive Compensation	Abstain	18.14%

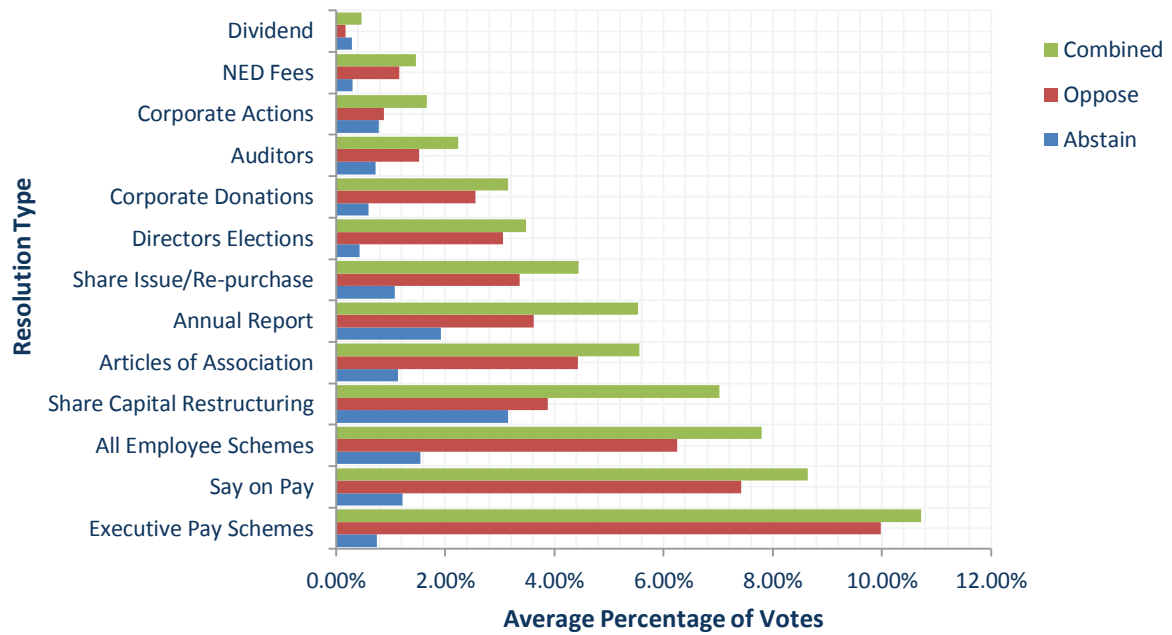
Table 7: Top 20 EU resolutions which received the highest percentage Oppose/Abstain vote

COMPANY NAME	PROPOSAL	VOTE	OPPOSE%
Total Sa	Shareholder Resolution: Approve Appointment of Employee Representatives to the Board and Amend Article 12.5 of Bylaws	Oppose	97.00%
Total Sa	Shareholder Resolution: Allow Loyalty Dividends to Long-Term Registered Shareholders and Amend Article 20 of Bylaws	Oppose	96.16%
Total Sa	Shareholder Resolution: Publication of a Quarterly Newsletter Written by Employee Shareholder Representatives	Abstain	83.21%
Schindler Holding Ag	Approve the Remuneration of the Board of Directors	Abstain	82.39%
Schindler Holding Ag	Approve the remuneration of the Group Executive Committee	Abstain	49.89%
Total Sa	Re-elect Paul Desmarais Jr	Oppose	49.56%
Novartis AG	Elect Ulrich Lehner as a member of the Compensation Committee	Oppose	33.08%
SAP Ag	Re-elect Wilhelm Haarmann	Oppose	32.39%
Terna - Rete Elettrica Nazionale Spa	Approve the Remuneration Report	Oppose	31.22%
Muenchener Rueck Ag	Re-elect Wolfgang Mayrhuber	Oppose	30.08%
TE Connectivity Ltd	Elect Thomas J. Lynch as Chairman of the Board of Directors.	Oppose	28.88%
Adecco Sa	Amend Articles of the Bylaws: create Articles 14bis, 20 and 20bis	Oppose	28.86%
SAP Ag	Elect Hagemann Snabe	Oppose	28.34%
SAP Ag	Re-elect Hasso Plattner	Oppose	25.62%
Novartis Ag	Elect Srikant Datar as a member of the Compensation Committee.	Oppose	25.33%
SAP Ag	Re-elect Hartmut Mehdorn	Oppose	23.96%
SAP Ag	Re-elect Erhard Schipporeit	Oppose	23.21%
SAP Ag	Re-elect Pekka Ala-Pietilae	Oppose	22.87%
Muenchener Rueck Ag	Re-elect Henning Kagermann	Oppose	22.10%
Muenchener Rueck Ag	Re-elect Ron Sommer	Oppose	19.44%

Table 8: Top 20 EU resolutions excluding shareholder proposals which received the highest percentage Oppose/Abstain vote

COMPANY NAME	PROPOSAL	VOTE	OPPOSE%
Schindler Holding Ag	Approve the Remuneration of the Board of Directors	Abstain	82.39%
Schindler Holding Ag	Approve the remuneration of the Group Executive Committee	Abstain	49.87%
Total Sa	Re-elect Paul Desmarais Jr	Oppose	49.56%
Novartis Ag	Elect Ulrich Lehner as a member of the Compensation Committee	Oppose	33.08%
SAP Ag	Re-elect Wilhelm Haarmann	Oppose	32.39%
Terna - Rete Elettrica Nazionale Spa	Approve the Remuneration Report	Oppose	31.22%
Muenchener Rueck Ag	Re-elect Wolfgang Mayrhuber	Oppose	30.08%
Te Connectivity Ltd	Elect Thomas J. Lynch as Chairman of the Board of Directors.	Oppose	28.87%
Adecco Sa	Amend Articles of the Bylaws: create Articles 14bis, 20 and 20bis	Oppose	28.86%
SAP Ag	Elect Hagemann Snabe	Oppose	28.34%
SAP Ag	Re-elect Hasso Plattner	Oppose	25.62%
Novartis Ag	Elect Srikant Datar as a member of the Compensation Committee.	Oppose	25.34%
SAP Ag	Re-elect Hartmut Mehdorn	Oppose	23.96%
SAP Ag	Re-elect Erhard Schipporeit	Oppose	23.21%
SAP Ag	Re-elect Pekka Ala-Pietilae	Oppose	22.85%
Muenchener Rueck Ag	Re-elect Henning Kagermann	Oppose	22.10%
Muenchener Rueck Ag	Re-elect Ron Sommer	Oppose	19.44%
Ryanair Limited	Approve the Remuneration Report	Oppose	18.79%
Bank of Ireland	To renew the directors' authority to issue ordinary stock on a non-pre-emptive basis other than for cash	Oppose	18.34%
Muenchener Rueck Ag	Re-elect Bernd Pischetsrieder	Oppose	17.50%

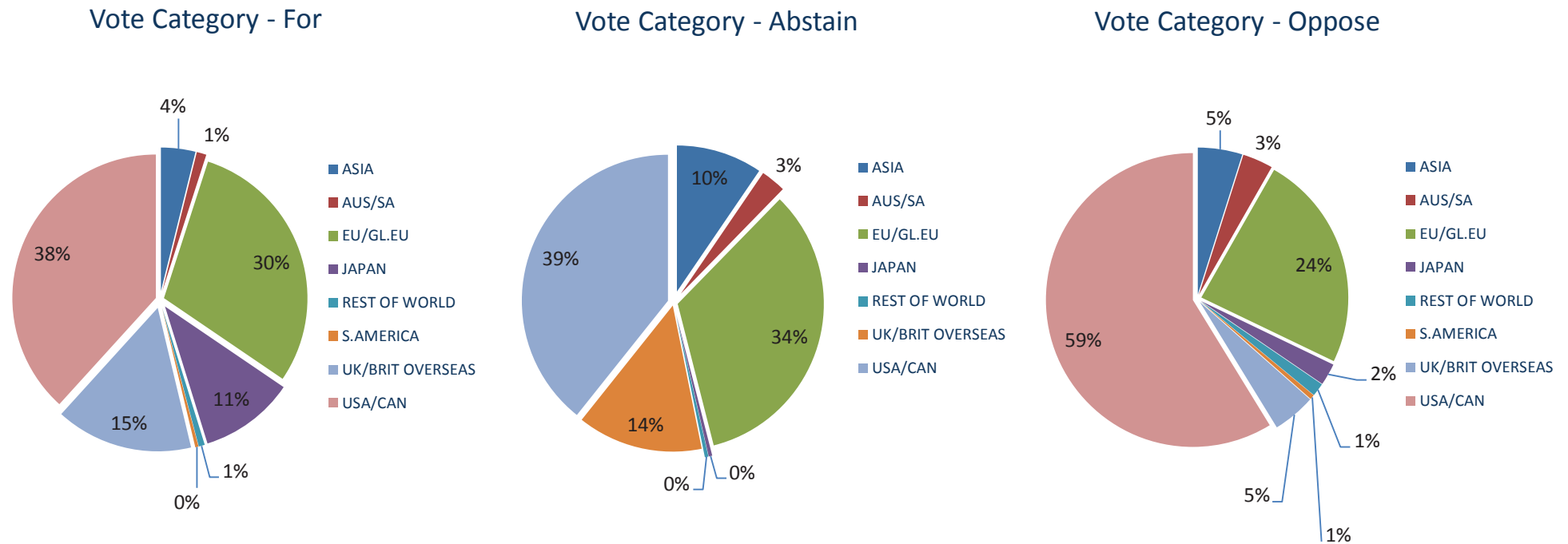
Graph 1 Most Contentious Resolution Types



\*Combined = Abstentions + Oppose votes.

Note: The resolutions classified as “**Shareholder Proposals**” (not included in the table) had the highest opposition proxy levels with an average of 70.47% of shareholders voting against the resolution and 4.42% abstaining.

Graph 2 Vote Categories by Region



a – Note that for Europe & Global EU, Not Supported vote category is included in Oppose graph; for US & Canada, Withhold vote category is included in Oppose graph.

## 5. AGM STORIES THROUGHOUT THE YEAR

### WH Smith PLC

AGM 22<sup>nd</sup> January 2014

**Remuneration is the main issue for this well known FTSE 250 retail bookseller and newsagent chain.**

Remuneration Report: Disclosure is considered generally good. Although WH Smith's year end means no binding vote was required at this AGM it would have been welcomed if information regarding the intended date of implementation was disclosed. In addition, further details of claw-back provisions would have been nice as it is not clear if the provisions operate on a recovery or withholding basis. Overall variable pay was potentially excessive and is set to become more excessive with increases in maximum award limits planned for 2014.

This can be seen when looking at the CEO pay as under the annual bonus, LTIP and co-investment plan; the maximum award totals an excessive 500% and while multiple performance criteria are used they are measured separately with a pay out possible on achieving a single criteria. Up to 75% of the CEO's salary is available for achieving the minimum (threshold) performance.

It is noted that one of the performance conditions attached to long term executive pay is the use of relative dividend which introduces a personal conflict of interest into decisions that should properly be based on execution of statutory duties.

There were concerns at the use of discretion by the committee to the apparent benefit of executives without obvious benefit to shareholders. Former CEO Kate Swann resigned on June 30<sup>th</sup> 2013. The large majority of incentive awards (around 1 million LTIP and MIP shares) held by Ms Swann were not exercisable at this point. Despite this Ms Swann was permitted to retain incentive awards on a reduced pro rata basis. Although allowed by scheme rules, it is not clear how these awards benefitted shareholders given she was no longer in a position to contribute to the company's performance. It is also unclear how permitting directors to keep awards on resignation aids retention.

### Roche Holdings

AGM 4<sup>th</sup> March 2014

**Swiss pay reform fight moves to the AGM trenches**

The old saying – you wait for ages for a vote on executive pay to come along then five turn up at the same time. This is a fitting description of the upcoming AGM ballot for Swiss pharma Roche where shareholders are being asked to vote on five separate pay related resolutions. The votes on pay arise from the implementation of Switzerland's new law Verordnung gegen übermässige Vergütungen bei börsenkotierten Aktiengesellschaften (Ordinance against excessive compensation in listed corporations or VeguV for short). Under the VeguV companies have some discretion over the exact nature of what they should seek approval for but they are required to set out the details of the vote in their articles of association.

As a result Roche is seeking approval for:

- 1) Binding approval of changes to the articles to give effect to the new ordinance
- 2) Binding approval of the total amount of future remuneration to the board
- 3) Binding approval of total amount of future remuneration for the Corporate Executive Committee
- 4) Binding retrospective approval for bonuses to the Corporate Executive Committee and Chairman
- 5) Advisory approval of the remuneration report which contains forward and backwards disclosures for both executive committee and board.



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Big pharma does not come much bigger than Roche, the world's largest biotech company and the third largest EU Company by market value so the way it has approached the new regulations will be important in setting the tone for other Swiss issuers.

On the face of it binding approval for forward and backward pay for board and executive committee may seem like full and proper accountability. Look a little closer and it becomes clear that the disclosure which supports the new votes is as solid as a piece of Swiss cheese.

Although shareholders now have a binding vote on total pay at Swiss companies caution still needs to be exercised. At Roche the amount of bonus to be approved does not show the value of shares awarded at market price but instead values awards on the assumption they are worth less if an executive is obliged to hold on to them.

The Swiss fight to reform excessive remuneration took a step forward with the passage of VeguV despite a vigorous corporate campaign to water down its effectiveness. Shareholders who support improved governance may now have to battle it out AGM by AGM to bring about meaningful transparency and disclosure.

### **Tullow Oil plc**

*AGM 30<sup>th</sup> April 2014*

**The Proposed remuneration policy is the main issue of concern at this FTSE 100 oil and gas exploration and production company.**

Remuneration Policy: Tullow proposed a major change in remuneration structure via the merger of the annual bonus and the long-term incentive into the Tullow Incentive Plan (TIP). With an individual limit of 600% of base salary it is considered very excessive. In addition, the Company did not consult employees when setting executive pay and its policy on contracts also raised concerns particularly the discretion to buy back forfeited awards when hiring new executives to the Board.

This tends to nullify the retentive effect that these schemes ought to have in the executive pay system.

Appointment of auditors: For the year under review Deloitte LLP was proposed. Non-audit fees represented 30.8% of the audit fees during the year and 35.1% on a three year aggregate basis. The figures raise some concerns over the independence on the external auditors as during the statutory audit they would be required to review their own work.

Board Composition: Overall the board was considered to have sufficient independent representation with 5 Non-Executive Directors, 5 Executives and 1 Chairman.

### **Reckitt Benckiser Group plc**

*AGM 7<sup>th</sup> May 2014*

**Independence, remuneration policy and female board representation are the main governance issues at this FTSE100 health, hygiene and home products company.**

Board Composition: Non Executive Directors Mr Peter Harf, Mr Kenneth Hydon and Ms Judith Spreiser were not considered independent and the board lacked independent representation. Mr Adrian Bellamy is Chair of the company. No target for female representation on the Board by 2015 was disclosed. Current representation stood at 10% (One director). As Mr Bellamy is Chair of the Nomination Committee as well as chairman of the board this dual role could lead to inappropriate influence on the committee's deliberations for succession planning.

Remuneration Policy: Maximum potential payouts under all incentive schemes for the Executives were considered excessive. There was no maximum cap disclosed as a percentage of base salary for the LTIP awards.

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The ratio of CEO pay compared to average employee pay was disclosed and was estimated to be 160:1 which is considered excessive. The LTIP uses three-year earnings growth as the sole performance measure, however best practice is to use at least two performance criteria in a concurrent fashion. The three-year performance period, without further holding requirement is also not considered sufficiently long-term. The recruitment policy allows for the replication of new appointees' forfeited schemes at their previous employers, which is an inappropriate practice. Provision for upside discretion existed in determining severance payments.

### **Bank of America Corporation**

*AGM 7<sup>th</sup> May 2014*

Executive compensation, shareholder director nominations, climate risk and disclosure of political lobbying were the key governance matters before the AGM of this S&P500 banking conglomerate.

Board Composition: Overall, it was considered that the Board has sufficient independent representation. The roles of Chairman and CEO were separated and out of 14 Non-Executive Directors only 3 were not considered independent due to tenure.

Advisory Vote on executive compensation: The Company submitted a proposal for shareholder ratification of its executive compensation policy and practices. Specific performance targets for the annual bonus are not disclosed. The committee does not provide material disclosures to assure shareholders that targets are challenging. There was a concern over the Compensation Committee having discretion in awarding additional bonuses. Only 50% of long term awards have performance based vesting.

Approval of Amendment to the Series T Preferred Stock: The Company was seeking shareholder approval of the amendment to the certificate of designations for the 6% Cumulative Perpetual Preferred Stock, Series T (the Series T Preferred Stock). The Series T Preferred Stock currently does not qualify as Tier 1 capital. If shareholders were to approve the Amendment at the annual meeting, the Tier 1 capital would increase by approximately \$2.9 billion, which will benefit the Tier 1 capital and leverage ratios, each of which is an important measure of the Company's regulatory capital adequacy.

Berkshire Hathaway Inc. and its affiliates are the holders of 100% of the outstanding shares of Series T Preferred Stock and have agreed to allow Bank of America as an irrevocable proxy to vote their shares of Series T Preferred Stock in favour of the Amendment. There are concerns regarding the Board's ability to tailor the vote as deemed appropriate by the Board. Additionally it is considered that the amended terms of this series of preferred stock will not benefit all shareholders equally.

Shareholder Resolution, Introduce cumulative voting: The proponent was requesting that the Board of Directors take the necessary steps to provide for cumulative voting in the election of directors, which means each shareholder shall be entitled to as many votes as shall equal the number of shares he or she owns multiplied by the number of directors to be elected, and he or she may cast all of such votes for a single candidate, or any two or more of them as he or she may see fit. The Board are against this proposal and argue that cumulative voting could be used by special interest groups to elect one or more directors sharing those groups' narrow interests, and that it could interfere with a diverse, balanced and effective Board. Cumulative voting systems are not supported as they can potentially allow small shareholder groups to have a disproportionate influence over the election of directors. The principle of "one share, one vote" is supported as best practice.

Shareholder Resolution, Proxy Access: The proponent requested the Board, to amend the governing documents to allow shareholders or groups of shareholders to make direct board nominations according to specified criteria around disclosure, stock holdings and eligibility periods with distribution of information relating to candidates and associated legal requirements distributed to all stockholder prior to elections for board positions. The Board opposed the resolution. The move, which would strengthen shareholder democracy and the requested threshold for holding requirement for nominators, is considered sufficient. In

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addition, the nomination of new Board members may assist independence in the oversight of the company. (Note: a similar proposal at the 2013 AGM received For Vote of 8.7 %.)

Shareholder Resolution, Climate Change Report: The proponents requested that the Board report to shareholders by September 2014, at reasonable cost and omitting proprietary information, Bank of America's assessment of the greenhouse gas emissions resulting from its financing portfolio and its exposure to climate change risk in its lending, investing, and financing activities. The Board believe that the company already provides publicly available information on the greenhouse gas emissions attributed to one of its most carbon-intensive business portfolios and the associated company policies and procedures to address related risks and opportunities. The proponent requests that the board publicly report on the company's indirect GHG exposure via its financing activities and its portfolio exposure to climate change risks. The company currently reports an estimate of its overall exposure to carbon emissions from its financing relationships with electric utilities. However, this reporting is only partial and does not address emissions from the company's clients in other industries. It is considered a reasonable practice that the board should commit to reporting on how climate change issues are integrated within its direct and indirect financing activities and its overall portfolio exposure.

Shareholder Resolution, Lobbying Report: The proponent had requested that the Board authorize the preparation of a report, updated annually, disclosing all political lobbying activity. The Board were against the proposal. It is viewed that not all lobbying activity by the company, as defined by the proponent, has been disclosed and that all shareholder funds should be accounted for as the amounts of shareholder funds mentioned are considered to be material, inclusion in the annual report is considered be a reasonable request for disclosure.

### **Vodafone Group Plc**

*AGM 29<sup>th</sup> July 2014*

**Remuneration, incentive plans and the appointment of auditors are the significant issues at this British multinational telecommunications company.**

Remuneration Policy: The Company operates one long term incentive plan (the GLTI) where awards vest subject to conditions which operate concurrently of each other, which is always welcomed. However, no non-financial KPI targets were used. At three years instead of five, the performance period is not considered sufficiently long term. Although an additional holding period was introduced for 50% of the awards.

The CEO's and other Executive Directors' total potential awards under all incentive schemes is considered excessive. The ratio of CEO pay to employee average pay was not disclosed; however, it is estimated and is considered excessive at 58 to 1.

Directors are entitled to a dividend income which is accrued on share awards from the date of grant, once awards vest. This policy is not considered in line with shareholders' best interests. Shareholding requirements by Directors in the Company are proposed, however no adequate period is in place.

The Company's recruitment policy allows for the replication of new appointees' forfeited schemes at their previous employers. This is considered an inappropriate practice. Upside discretion may be used while determining severance. Mitigation arrangements exist. A claw-back policy is also in place.

Remuneration Report: Rewards made to the Executive Directors for the year are considered excessive in comparison with their base salaries. Realised variable remuneration for the CEO in the year is almost seven times his base salary. In addition, the balance of CEO realised pay with financial performance is not considered acceptable.

Approval of Vodafone Global Incentive Plan: Performance targets are not disclosed sufficiently for the plan and the performance period is considered too short. Taking into consideration the other variable schemes in

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aggregate the LTIP is considered excessive. Vesting of awards may be accelerated in the event of cessation of employment, which is considered inappropriate as executives may be rewarded for performance not obtained.

The directors have the ability to amend or waive any performance conditions without shareholders approval. Such a high level of discretion negates the purpose of safeguards. Furthermore, Long Term Incentive Plans based schemes are inherently flawed. There is the inherent risk that they are rewarding volatility rather than the performance of the company (creating capital and - lawful - dividends). They are inherently acting as a complex and opaque hedge against absolute company under-performance and long-term share price falls.

Appointment of Auditors: PricewaterhouseCoopers LLP are proposed to replace Deloitte LLP. There are concerns over the independence of PwC; Vodafone Non-Executive Philip was on the advisory Board of PwC until January 2014, which compromises the independence of both parties. The move of Mr Yea from the Remuneration Committee to the Audit Committee further aggravates the issue. The independence of the auditor is of paramount importance to ensure objectivity of the Auditor and confidence in financial reporting. PwC was acting as the Company's Remuneration Consultant for a number of years until they stepped down to be appointed Auditor of the Company. PwC has also provided the Group with a wide range of consulting and assurance services. This long association with the Company creates potential for conflicts of interests.

### **Diageo Plc**

*AGM 18<sup>th</sup> September 2014*

**Remuneration policies are the main issues at this US & UK listed FTSE 100 company, currently the worlds largest spirit producer.**

Approval of Remuneration Report: Rewards made to the Executive Directors for the year were considered excessive in comparison with their base salaries. The CEO variable pay was over three times his base salary and realised pay over the last five years was not commensurate with financial performance.

Approve Remuneration Policy: Disclosure was considered acceptable. The Company will operate one long-term incentive scheme, the Diageo Long Term Incentive Plan (DLTIP). Simplification of remuneration structure is welcomed.

Awards vest subject to four different performance metrics which work independently of each other. These conditions should operate concurrently i.e. both threshold targets must be met for any awards to vest. It is considered best practice to include a non-financial performance measure, which has not been the case for the DLTIP. At three years (instead of five) the performance period is not considered sufficiently long term. It is noted the Committee is proposing a two-year holding period for vesting awards.

The Executive Directors' total potential rewards under all incentive schemes are considered to be excessive as they may amount to 700% of base salary. The ratio of CEO pay to employee average pay is not disclosed; however it is estimated to be approximately 34 to 1.

Whilst directors are required to build and retain an appropriate shareholding in the Company, the 5-year time frame is not considered adequate and best practice recommends three years. Schemes are not available to enable all employees to benefit from business success without subscription.

The Company's recruitment policy allows for the replication of new appointees' forfeited schemes at their previous employers. This is considered an inappropriate practice as it undermines the rationale behind the remuneration policy to retain Executive Directors. Upside discretion may be used while determining severance. Vesting of awards may be accelerated at the date of cessation. Claw-back provisions are in place for the bonus and DLTIP awards. Mitigation arrangements also exist.

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Board Composition: The board is considered properly balanced with sufficient Non-Executive Directors (8) to be able to effectively counterbalance the Executive (2) element. The only concern lay with Peggy Bruzelius who currently has 6 NED positions and 1 Chairmanship raising concerns over her aggregate time commitments.

Appointment of auditors: For the year under review KPMG LLP was proposed. Non-audit fees represented 17.54% of the audit fees during the year and 43.52% on a three year aggregate basis. The figures raise some concerns over the independence on the external auditors as during the statutory audit they would be required to review their own work.

Approve Political Donations: The board is seeking shareholder approval to make political donations to political parties and/or independent election candidates, political organisations, and to incur political expenditure up to a total of to £100,000. The aggregate total is within recommended limits and the authority expires at the next AGM. However, the group made contributions to Non-EU political parties totalling £0.4 million during the year which is above recommended limits.

Approve new Long Term Incentive Plan: The DLTIP is proposed to replace the existing Diageo 2008 Performance Share Plan (PSP) and the Diageo 2008 Senior Executive Share Option Plan (SESOP). The scheme expires in 10 years. The amount of awards that may be granted under the scheme will not exceed 10% of the Company's issued ordinary share capital. Awards will take the form of performance share awards or market price share options (valued at one-third of a performance share). The grants are individually capped at 500% of base salary. Awards are subject to a performance period of three years.

However, the performance period of three years is not considered sufficiently long term. The DLTIP awards are excessive particularly when aggregated with other variable schemes and can lead to overly generous payouts. Dividend equivalents may be accrued on share awards from the date of grant, on vesting awards.

This policy is not considered in line with shareholders best interests despite there being malus provisions for awards made under the plan.

There are concerns that vesting of awards may be accelerated in the event of cessation of employment which is inappropriate as executives may be rewarded for performance not obtained. The Directors also have the ability to amend or waive any performance conditions without shareholders approval. Such a high level of discretion negates the purpose of safeguards.

## **Ryanair Holdings Plc**

*AGM 25th September 2014*

**Remuneration and Board independence are the major governance issues at this high profile FTSE Eurofirst budget airline.**

Annual Report: Disclosure is partial in that there are no quantitative targets for reporting environmental policy. There are concerns that the Executive Committee can exercise the powers of the full Board of Directors in circumstances in which action by the Board of Directors is required but it is impracticable to convene a meeting of the Directors. The operational circumstance for this arrangement is not clearly defined.

In addition, the Executive Committee is composed of members not consider independent. Furthermore, Non-Executive Directors participate in the Company's share option plan, which contravenes governance best practice.

Remuneration Report: The Policy supports a mix between fixed and variable remuneration. The annual bonus is capped at 100% of the base salary, while no information is available with respect to the annual amount of the long term incentives as a rate of the fixed salary it appears possible for variable pay to exceed the target of fixed pay where targets are exceeded. Targets and measured criteria were not disclosed, making an accurate

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assessment difficult. No disclosure was made around levels of targets and minimum thresholds applied to the annual bonus in the year under review and achievement against these targets.

Board Composition: The board is made up of 9 Non-Executive Directors of which 4 are not considered independent. The nomination committee includes the CEO, which raises concerns over the transparency of the selection and appointment procedures. Limited biographical information was made available about the director Charlie McCreedy. He was appointed to the Board back in May 2010. The Company did not whether he handles cases concerning the company during his term of office at the European Commission.

Allow the board to determine the auditor's remuneration: The auditing firm has not been rotated since 1985, which is not considered to be in accordance with best practice. The level of non-audit fees paid to the auditor raise concerns both for the year under review (60% of the audit fees) and over the last three years (71%). While shareholders are allowed to vote in regards to the remuneration of the auditors they have no say on the election of the auditor which is not considered best practice and raises concerns over their independence.

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## APPENDIX

The regions are categorised as follows:

<b>ASIA</b>	China; Hong Kong; Indonesia; India; Korea; Singapore; Taiwan
<b>AUS /SA</b>	Australia; South Africa
<b>EU/GL. EU</b>	Austria; Belgium; Switzerland; Germany; Denmark; Spain; France; Italy; Luxembourg; Netherlands; Sweden; Norway; Greece; Finland; Ireland
<b>JAPAN</b>	Japan
<b>USA/CAN</b>	USA; Canada; Bermuda
<b>UK</b>	UK
<b>S. AMERICA</b>	Brazil; Argentina
<b>REST OF WORLD</b>	Russia

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Email [info@pirc.co.uk](mailto:info@pirc.co.uk)

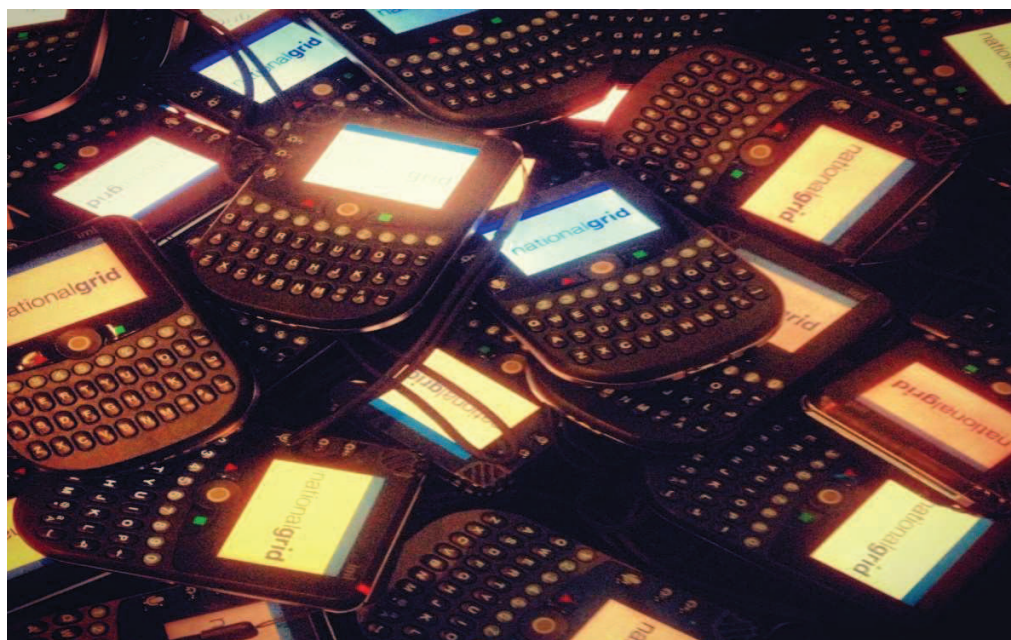
[www.pirc.co.uk](http://www.pirc.co.uk)





# QUARTERLY ENGAGEMENT REPORT

JULY TO SEPTEMBER 2014



Voting machines at National Grid AGM

## Local Authority Pension Fund Forum (LAPFF)

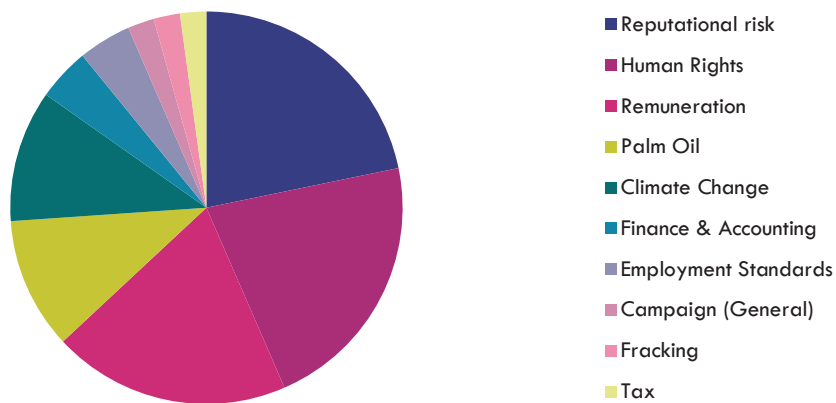
LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Formed in 1990, LAPFF brings together a diverse range of local authority pension funds in the UK with combined assets of over £150 billion, [www.lapfforum.org](http://www.lapfforum.org).

# ENGAGEMENT SUMMARY

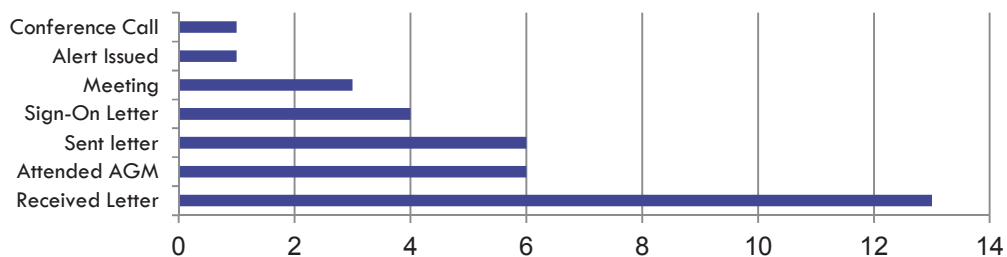
**JULY TO SEPTEMBER 2014**

The Forum engaged with **30 companies** over the period

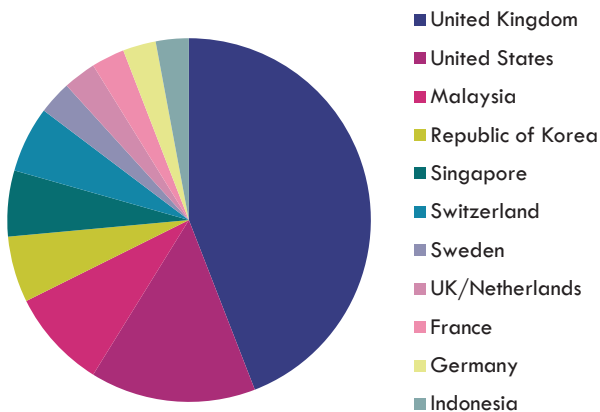
## Topics



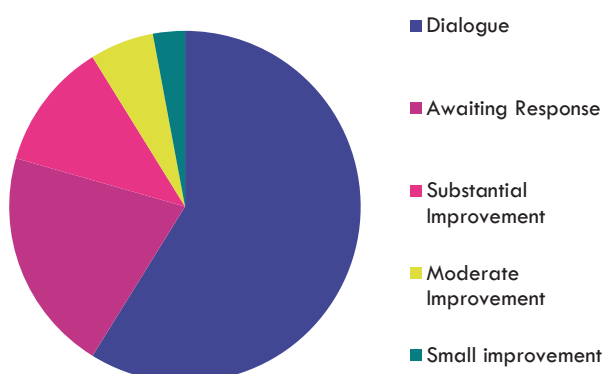
## Activities



## Company Domicile



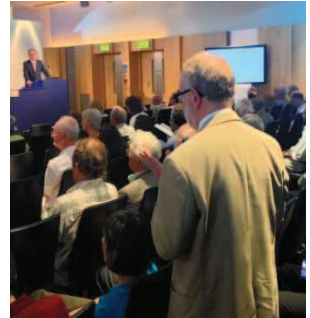
## Outcome



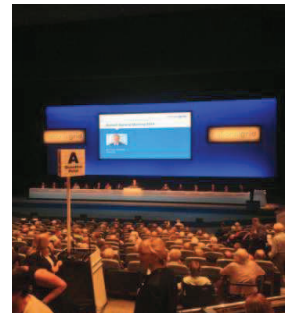
# ACHIEVEMENTS

During the Quarter, LAPFF has maintained a consistent profile, engaging on governance and corporate responsibility concerns and publicly raising significant shareholder issues by direct questioning at company AGMs as part of the engagement process.

- Cllr Greening questioned the board on the links between executive pay and longer term climate risks and mitigation strategies at the **British Land** AGM.
- Asked the chair of **Vodafone** at the AGM about excessive executive pay, given the Company's performance has not been very strong over the past year. Received response to Cllr Greening's question that bonuses rarely result in a 100% payout and that the long term incentive metric outperformed the market.
- Cllr Greening also questioned **Betfair** at its AGM over illegal dividends and share buybacks after LAPFF issued a voting alert on this topic.
- Cllr Cameron Rose attended the **BT Group** AGM to ask how the Company ensures that its customer service performance is adequately reflected in pay incentives when the importance of this area has been downgraded in the performance metrics.
- Raised concerns over remuneration at the **Burberry** AGM in light of the increase in salary and other arrangements for the newly appointed CEO Christopher Bailey.
- Attended the **National Grid** AGM to continue engagement around progress towards achieving a top level within the Carbon Disclosure Project's Climate Performance Leadership Index. Were told that LAPFF was the first investor group to raise the issue of progress on reporting Scope 3 emissions.
- After collaborative engagement on sustainable palm oil practices, **Sime Darby**, **Kuala Lumpur Berhad**, **Asian Agri Resources** and **IOI Group** have announced an immediate moratorium on clearance of high carbon stock forests.
- Met with **G4S**'s senior independent director to discuss changes at the head of the company and the effect on operational and reputational risk management including challenges from complex, international contracts, diversity and succession planning.
- Met with **Glencore** for a second time on carbon management within the Aiming for A investor initiative, as well as raising other social and governance risk management concerns.
- Pursued previous engagement with **BAE** by meeting with the chair, Sir Roger Carr. Topics covered anti-corruption processes, executive pay and gender diversity at board level as well as throughout the company.



British Land AGM



National Grid AGM

## THE FORUM IN THE NEWS

Director Remuneration

[Lexology](#)

Local Government Pension Schemes

[Local Government Chronicle](#), [Investment and Pensions Europe](#)

LAPFF targets SportsDirect over Mike Ashley's pay package

[City A.M.](#), [Reuters](#), [Investment & Pensions Europe](#), [The Guardian](#), [BBC](#), [Evening Standard](#), [The Journal](#), [Express and Star](#)

Corporate Governance Code

[Financial Times](#), [Accountancy Age](#)

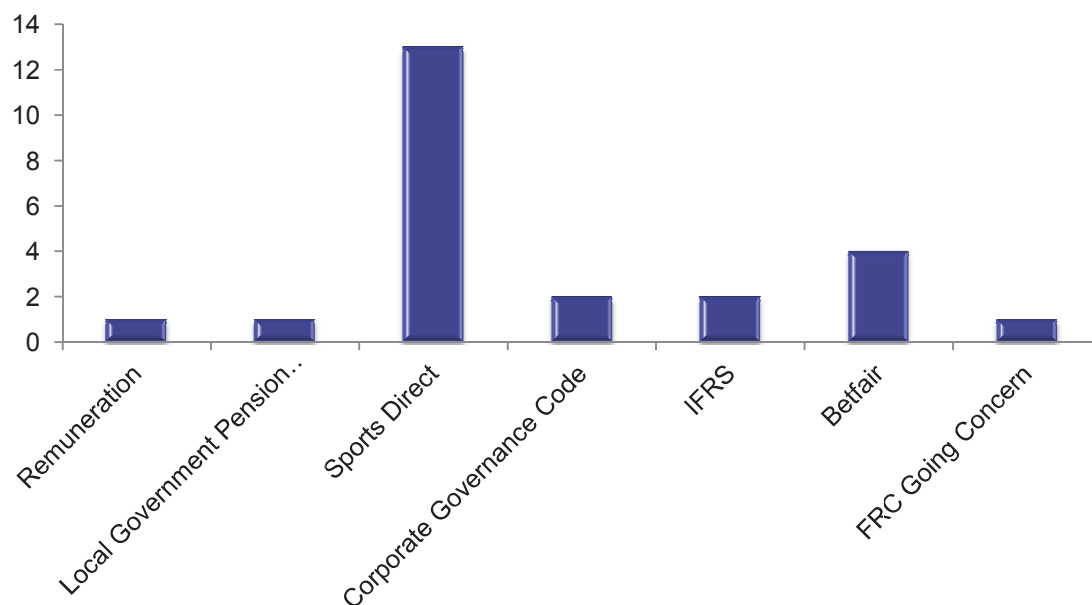
IFRS Failings

[Professional Pensions](#), [Investment and Pensions Europe](#), [Financial Director](#)

Betfair

[Sunday Telegraph](#), [SBC News](#), [economia](#), [Financial News](#), [Shares Magazine](#), [Chinese press](#).

### LAPFF Press Mentions, Q3 2014



# COMPANY ENGAGEMENT

## LEADERSHIP ON KEY CAMPAIGNS

The issue of the production and sale of cluster munitions was raised at the June executive meetings and LAPFF agreed to engage with nine aerospace and defence companies over the production and sale of cluster munitions. The concern is that these weapons kill people indiscriminately and that they continue to be dangerous after conflicts have ended. Of the companies contacted – **Textron, ATK, L-3, General Dynamics, Lockheed Martin, Doosan, Hanwha** and **Singapore Technologies** – four have responded to letters requesting confirmation that these companies do not produce or sell cluster munitions.

By and large, the responses received so far state that the companies do not produce or sell cluster munitions within the definition of the Oslo Convention. However, neither the U.S. nor South Korea – both of which are major clients of these firms – have ratified or acceded to the Oslo Convention. This lack of state commitment to the law makes it more difficult to discern the extent of companies' involvement.

A meeting was held with the chair of **BAE**, Sir Roger Carr, to discuss cluster munitions and to follow up from previous meetings with the company. Sir Roger provided assurances that BAE is completely compliant with the terms of the Oslo Convention, which is the international law that bans cluster munitions. The meeting gave the opportunity to assess progress on anti-corruption processes, looked at simplification of pay arrangements and assessed the measures BAE was putting in place to ensure not only board diversity, but gender diversity throughout the company.

## PROMOTING GOOD GOVERNANCE

### Executive Pay

LAPFF continues to push companies on their executive pay arrangements, especially in relation to rewards for sub-par performance and on complexity. At the **Vodafone** AGM, Cllr Greening asked Chairman Gerard Kleisterlee how the Company could have rewarded its executives with variable pay when the financials for the year were not good. Mr Kleisterlee responded that bonus payments rarely reach a 100% payout and that metrics informing the long term incentive plan outperformed the market. However, he did not address the lack of a link between pay and performance.



A second meeting with the senior independent director of **G4S**, aimed to ascertain whether changes at the head of the Company have led to better operational management on the



ground and have lessened reputational risk. The new chief executive, Mr Almanza, appears to be making significant changes, and post-Olympics, the company believes there is improved contract assurance and greater scrutiny of contracts with newly established risk committees at the executive and board levels to deal with complex contracts. LAPFF again raised the issue of pay complexity. The company has engaged extensively with its major shareholders, but has come up against opposing investor opinion on metrics. A follow-up phone call established that some elements of the EPS adjustments were confusing and would be removed.

Complex pay arrangements are also of concern at **Hays**. Hays' scheme is problematic in that it has too many components, six in total, thus making it difficult for investors to track payments and whether the payments were deserved. LAPFF has written to the company seeking a meeting. At the **BT** AGM, Cllr Rose asked how pay incentives helped improve customer service given that the relative importance of customer service has dropped in the Company's performance metrics for executives.

## Reliable Accounts

**Betfair** has stated in its Annual Report that it paid illegal dividends and share buyback distributions for the years 2011, 2012 and 2013. LAPFF issued a voting alert ahead of the September AGM aiming to hold relevant Board members responsible for the distribution payments. The alert includes a recommendation to abstain on the resolution approving the payment of dividends for the year under review as it is not clear that the accounting problems have been remedied. It appears that the illegal dividends were paid in part because the Company's accounts were not audited in line with the 'true and fair view' standard set at law.

## MANAGING ENVIRONMENTAL RISK

### Palm oil

LAPFF's engagement with companies to encourage sustainable palm oil production and supplies has met some success. A group of palm oil growers, including **Sime Darby**, **Kuala Lumpur Berhad**, **Asian Agri Resources** and **IOI Group**, released a 'Sustainable Palm Oil Manifesto' directed at ensuring future palm oil developments are subject to high standards of environmental protection and limit deforestation. While the Manifesto might be regarded as a step forward, LAPFF shared concerns that it does not set the same strong standards as those followed by major industry leaders whom the Forum has supported such as Wilmar and Golden-Agri.



The Manifesto does not adequately extend to the companies' third party suppliers or protect peatlands and allowed the companies to continue deforestation while definitional issues are resolved. LAPFF again co-signed letters with Green Century Capital Management to raise these concerns with these companies, seeking an immediate moratorium on deforestation and

requested the companies adopt a time-bound plan for fully traceable palm oil. By mid-September members of the Palm Oil Manifesto Group announced that they would be adopting an immediate moratorium on clearance of high carbon stock forests.

LAPFF is continuing to work with the **PRI Investor Group** and is participating in collective engagement with the largest buyer of palm oil from an Indonesian supplier on working to find a way to engage with that supplier over concerns with its practices for palm oil production.

## Energy and Environmental Risk



LAPFF has continued to engage on climate risks at AGMs during the 2014 season. At the **British Land** AGM, Cllr Greening focussed on the extent to which the Company has considered future climate impacts in land purchase and developments, particularly flood and inundation risk. The board was also asked about the Company's influence with local authorities to

improve sustainability and resilience factors in housing and commercial developments. The concern is that if climate impacts have not been considered adequately, both in location and design, British Land developments could face longer term risks from extreme weather or other environmental impacts. If these risks materialise, they could affect shareholder value.

This extended notion of climate risks was reflected in the question asked to Sir Peter Gershon, the **National Grid** chairman, at the company's AGM regarding measurement and reporting of Scope 3 emissions. To date, most companies have focused reporting on Scope 1 and 2 emissions. However, it is important to recognise that company emission profiles encompass their supply chains and major contractors, or Scope 3 emissions. This AGM attendance continues LAPFF's participation in the 'Aiming for A' engagement which encourages company progress within the Carbon Disclosure Project's Climate Performance Leadership Index. The Chair, Sir Peter Gershon, noted that LAPFF was the first investor group to raise the issue of progress on monitoring Scope 3 emissions. Identifying the emissions profiles generated throughout complex supply chains also helps to begin to address the deeper issues of climate risk management and the development of adaptation and resilience measures critical to energy supply companies operating vital infrastructure networks.



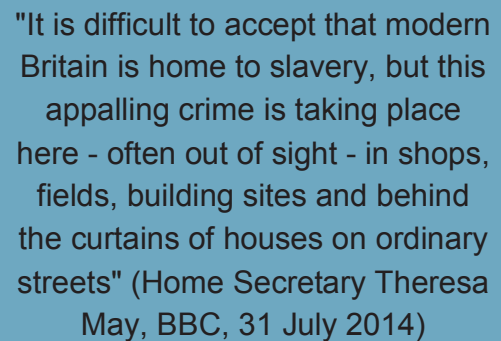
LAPFF continued its engagement with **Glencore** on carbon management within a discussion on the overall environmental, social and governance risk management processes. Questions were posed both at a sustainability presentation and a separate meeting with the head of the board environment and safety committee. On its carbon management, the company was encouraged to establish emissions reduction initiatives and set associated targets in order to

and to clearly identify links between the initiatives and reductions made. Closer questioning on performance against health and safety metrics indicated a more effective monitoring system being implemented. On board governance, succession planning and gender and other aspects of diversity were addressed.

## TARGETING SOCIAL ISSUES

### Employment Standards

The issue of modern day slavery is beginning to rise on companies' radars. Recent reports on Asian slave labour helping to produce prawns destined for US and UK supermarkets and the UK Government's Modern Slavery Bill, introduced in June has given a greater focus on transparency in supply chains. For extractive companies such as Glencore, concerns include child labour, artisanal mining and exposure to social risks particularly in countries such as Mauritania.



"It is difficult to accept that modern Britain is home to slavery, but this appalling crime is taking place here - often out of sight - in shops, fields, building sites and behind the curtains of houses on ordinary streets" (Home Secretary Theresa May, BBC, 31 July 2014)

### Social and Reputational Risks

LAPFF continues to engage with a range of stakeholders in order to inform better campaign and engagement approaches. Western Sahara Resource Watch (WSRW) requested a meeting to explain its position on company engagement in Western Sahara. Citing a UN legal decision on Western Sahara's right to exploit its natural resources as a Non-Self-Governing Territory, the organisation takes the stance that Morocco is illegally occupying Western Sahara and that therefore foreign companies, particularly phosphate and oil companies, should not be signing contracts with Morocco in relation to projects in Western Sahara. WSRW would like to see the political situation between Morocco and Western Sahara resolved before foreign companies undertake projects in Western Sahara. It believes this resolution would allow companies to engage with Saharawis to ensure that projects are mutually beneficial.



# CONSULTATIONS & PUBLIC POLICY

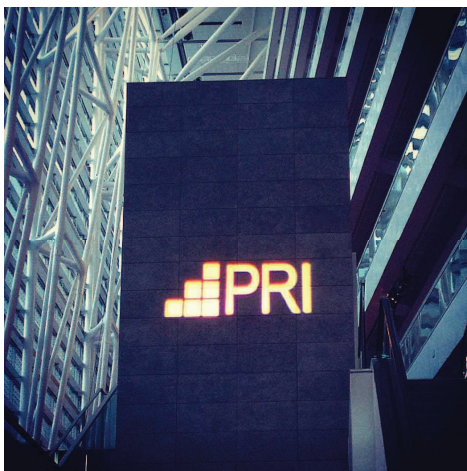
## ENGAGING WITH POLICY-MAKERS

LAPFF has co-signed a letter to the International Organisation of Securities Commissions (**IOSCO**) to support working more closely with regulators, stock exchanges and other related parties to improve the disclosure of material and high-quality corporate Environmental, Social and Governance information in the global marketplace.

LAPFF hosted fringe meetings at the **Labour Party Conference** and the **Conservative Party Conference** on 'The Future of the Local Government Pension Scheme.' Speakers included the LAPFF chair, Cllr Kieran Quinn, Henry Boucher of Sarasin and Partners and Cllr Denise Le Gal, Chair, Surrey Pension Fund.

## NETWORKS & EVENTS

- **30% Club Investor Group** – 'Next steps for accelerating change' with CEO of Women on Boards
- **Glencore Sustainability Presentation** by Tony Hayward (Chairman), Ivan Glasenberg (CEO) and Peter Coates (Chair of HSEC Committee)
- **CCLA** – event highlighting the importance of collective action on climate change, hosted by St Paul's/CCLA.
- **Threadneedle/UKSIF** event on UK preparations for fracking
- **Clifford Chance** – seminar on whether an arbitration tribunal similar to investment tribunals would be feasible for human rights
- **PRI in Person, Montreal** – included debates on fossil fuel divestment, investor tax responsibility, green bonds, fracking, human rights in extractives and executive remuneration



# COMPANY PROGRESS REPORT

Company	Topics	Outcome
Glencore	Carbon management, board diversity	Small Improvement
<b>Textron</b>	Reputational risk, human rights	Dialogue
<b>Alliant Techsystems</b>	Reputational risk, human rights	Awaiting Response
<b>L-3 Communications</b>	Reputational risk, human rights	Dialogue
<b>General Dynamics</b>	Reputational risk, human rights	Awaiting Response
<b>Lockheed Martin</b>	Reputational risk, human rights	Dialogue
<b>Doosan</b>	Reputational risk, human rights	Awaiting Response
<b>Hanwha Corporation</b>	Reputational risk, human rights	Awaiting Response
<b>Singapore Technologies</b>	Reputational risk, human rights	Dialogue
Hays	Remuneration	Dialogue
Astrazeneca	Mergers and acquisitions	Dialogue
BAE Systems	Remuneration, board composition	Moderate Improvement
Burberry Group	Remuneration	Dialogue
BT Group	Remuneration	Dialogue
British Land	Remuneration, climate change	Dialogue
G4S	Remuneration, human rights	Moderate Improvement
National Grid	Carbon management	Dialogue
Svenska Handelsbanken	Remuneration	Dialogue
National Express	Employment standards	Dialogue
Vodafone	Remuneration, tax	Dialogue
<b>Betfair</b>	Finance & accounting	Dialogue
<b>Sime Darby</b>	Sustainable palm oil	Substantial Improvement
<b>Kuala Lumpur Berhad</b>	Sustainable palm oil	Substantial Improvement
<b>Asian Agri Resources</b>	Sustainable palm oil	Substantial Improvement
<b>IOI Group</b>	Sustainable palm oil	Substantial Improvement
Novartis	Holdings Based Engagement	Dialogue
Total	Carbon management, fracking	Dialogue
Deutsche Telekom	Employment Standards	Dialogue
Severn Trent	Remuneration	Dialogue
<b>Olam</b>	Sustainable palm oil	Dialogue

Companies LAPFF has not previously engaged with individually are indicated in bold.

## Local Authority Pension Fund Forum Members

Avon Pension Fund  
Barking and Dagenham LB  
Bedfordshire Pension Fund  
Camden LB  
Cheshire Pension Fund  
City of London Corporation  
Clwyd Pension Fund  
Croydon LB  
Cumbria Pension Scheme  
Derbyshire CC  
Devon CC  
Dorset County Pension Fund  
Dyfed Pension Fund  
Ealing LB  
East Riding of Yorkshire Council  
East Sussex Pension Fund  
Enfield LB  
Falkirk Council  
Greater Gwent Fund  
Greater Manchester Pension Fund  
Greenwich Pension Fund RB  
Gwynedd Pension Fund  
Hackney LB  
Hampshire Pension Fund  
Haringey LB  
Harrow LB  
Hounslow LB  
Islington LB  
Lancashire County Pension Fund  
Lambeth LB  
Lewisham LB

Lincolnshire CC  
London Pension Fund Authority  
Lothian Pension Fund  
Merseyside Pension Fund  
Newham LB  
Norfolk Pension Fund  
North East Scotland Pension Fund  
North Yorkshire CC Pension Fund  
Northamptonshire CC  
NILGOSC  
Nottinghamshire CC  
Rhondda Cynon Taf  
Sheffield City Region Combined  
Authority  
Shropshire Council  
Somerset CC  
South Yorkshire Pensions Authority  
Southwark LB  
Staffordshire Pension Fund  
Surrey CC  
Teesside Pension Fund  
Tower Hamlets LB  
Tyne and Wear Pension Fund  
Waltham Forest LB  
Wandsworth LB  
Warwickshire Pension Fund  
West Midlands PTA Pension Fund  
West Midlands Pension Fund  
West Yorkshire Pension Fund  
Wiltshire CC  
Worcestershire CC

Report prepared by PIRC Ltd. for the Local Authority Pension Fund Forum

**PIRC**



## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: 'All'
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## **UK Stewardship Code compliance**

(Appendices 'A' and 'B' refer)

Contact for further information:

Andrew Fox, (01772) 535916, County Treasurer's Directorate,

Andrew.fox@lancashire.gov.uk

### **Executive Summary**

The Financial Reporting Council (FRC) strongly encourages all institutional investors to publish a statement on their website on the extent to which they have complied with the seven principles of the UK Stewardship Code. The Stewardship Code is principally aimed at asset managers, however other institutional investors, including pension funds, are encouraged to report under it, and it is considered best practice to do so.

Appendix A is a copy of the latest Stewardship Code.

In September 2013, the Pension Fund Committee approved the Fund's first statement of compliance with the Stewardship Code. This is subject to annual review, and accordingly Appendix B sets out the proposed Stewardship Code Compliance Statement for the Fund. The adoption of this statement and identified actions will ensure the Fund's compliance with the Code.

### **Recommendation**

The Committee is requested to approve the Stewardship Code Compliance Statement for 2014.

## Background and Advice

Following the financial crisis of 2008, one of the recommendations of the Walker Review of Corporate Governance of the UK Banking Industry was that the Financial Reporting Council (FRC) should have responsibility for a new Stewardship Code, setting out best practice in respect of investor engagement. This Code was to be based upon the Institutional Shareholders Committee (ISC) document – 'the Responsibilities of Institutional Shareholders and Agents.'

The FRC published its first version of the Stewardship Code in 2010, and subsequently updated it in September 2012. A copy of the Code is attached as Appendix A. It is expected that institutional investors publish a statement in respect of their adherence, or otherwise, to the Code in a way that mirrors 'comply or explain' statements made by companies under the Corporate Governance Code.

The FRC strongly encourages all institutional investors to publish a statement on their website on the extent to which they have complied with the seven principles of the Code. The Stewardship Code is principally aimed at asset managers, however other institutional investors, including pension funds, are encouraged to report under it, and it is considered best practice to do so.

The Principles of the Code are as follows:

*So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:*

- 1. publicly disclose their policy on how they will discharge their stewardship responsibilities.*
- 2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.*
- 3. monitor their investee companies.*
- 4. establish clear guidelines on when and how they will escalate their stewardship activities.*
- 5. be willing to act collectively with other investors where appropriate.*
- 6. have a clear policy on voting and disclosure of voting activity.*
- 7. report periodically on their stewardship and voting activities.*

In September 2013, the Pension Fund Committee approved the Fund's first statement of compliance with the Stewardship Code. This is subject to annual review, and accordingly Appendix B is the proposed statement of compliance for 2014. There are no significant changes from that approved in 2013. The adoption of this statement and identified actions will ensure the Fund's compliance with the Code.

## **Consultations**

N/A

## **Implications:**

In approving a compliance statement, Lancashire County Pension Fund is demonstrating its commitment to the UK Stewardship Code and the promotion of behavioural changes that will lead to better corporate governance by asset managers and companies.

## **Risk management**

Signing up to the Code demonstrates that the Pension Fund believes that companies should adhere to the highest standards of governance. By not doing so, the Fund's reputation may be weakened.

## **Local Government (Access to Information) Act 1985 List of Background Papers**

Paper	Date	Contact/Directorate/Tel
Financial Reporting Council – UK Stewardship Code	2012	Andrew Fox/ County Treasurer's Directorate x35916

Reason for inclusion in Part II, if appropriate

N/A







September 2012

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# The UK Stewardship Code

The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

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## Stewardship and the Code

1. Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.
2. In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.
3. The UK Corporate Governance Code identifies the principles that underlie an effective board. The UK Stewardship Code sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the “comply or explain” system.
4. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.
5. Institutional investors’ activities include decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling specific securities. The division of duties within and between institutions may span a spectrum, such that some may be considered asset owners and others asset managers.
6. Broadly speaking, asset owners include pension funds, insurance companies, investment trusts and other collective investment vehicles. As the providers of capital, they set the tone for stewardship and may influence behavioural changes that lead to better stewardship by asset managers and companies. Asset managers, with day-to-day responsibility for managing investments, are well positioned to influence companies’ long-term performance through stewardship.
7. Compliance with the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.

## Application of the Code

1. The UK Stewardship Code traces its origins to 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles,' first published in 2002 by the Institutional Shareholders Committee (ISC), and which the ISC converted to a code in 2009. Following the 2009 Walker Review of governance in financial institutions, the FRC was invited to take responsibility for the Code. In 2010, the FRC published the first version of the UK Stewardship Code, which closely mirrored the ISC code. This edition of the Code does not change the spirit of the 2010 Code.
2. The Code is directed in the first instance to institutional investors, by which is meant asset owners and asset managers with equity holdings in UK listed companies. Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their responsibility for stewardship. They remain responsible for ensuring those activities are carried out in a manner consistent with their own approach to stewardship. Accordingly, the Code also applies, by extension, to service providers, such as proxy advisors and investment consultants.
3. The FRC expects signatories of the Code to publish on their website, or if they do not have a website in another accessible form, a statement that:
  - describes how the signatory has applied each of the seven principles of the Code and discloses the specific information requested in the guidance to the principles; or
  - if one or more of the principles have not been applied or the specific information requested in the guidance has not been disclosed, explains why the signatory has not complied with those elements of the Code.
4. Disclosures under the Code should improve the functioning of the market for investment mandates. Asset owners should be better equipped to evaluate asset managers, and asset managers should be better informed, enabling them to tailor their services to meet asset owners' requirements.
5. In particular the disclosures should, with respect to conflicts of interest, address the priority given to client interests in decision-making; with respect to collective engagement, describe the circumstances under which the signatory would join forces with other institutional investors to ensure that boards acknowledge and respond to their concerns on critical issues and at critical times; and, with respect to proxy voting agencies, how the signatory uses their advice.
6. The statement of how the Code has been applied should be aligned with the signatory's role in the investment chain.
7. Asset owners' commitment to the Code may include engaging directly with companies or indirectly through the mandates given to asset managers. They should clearly communicate their policies on stewardship to their managers. Since asset owners are the primary audience of asset managers' public statements as well as client reports on stewardship, asset owners should seek

to hold their managers to account for their stewardship activities. In so doing, they better fulfil their duty to their beneficiaries to exercise stewardship over their assets.

8. An asset manager should disclose how it delivers stewardship responsibilities on behalf of its clients. Following the publication in 2011 of the Stewardship Supplement to Technical Release AAF 01/06, asset managers are encouraged to have the policies described in their stewardship statements independently verified. Where appropriate, asset owners should also consider having their policy statements independently verified.
9. Overseas investors who follow other national or international codes that have similar objectives should not feel the application of the Code duplicates or confuses their responsibilities. Disclosures made in respect of those standards can also be used to demonstrate the extent to which they have complied with the Code. In a similar spirit, UK institutions that apply the Code should use their best efforts to apply its principles to overseas equity holdings.
10. Institutional investors with several types of funds or products need to make only one statement, but are encouraged to explain which of their funds or products are covered by the approach described in their statements. Where institutions apply a stewardship approach to other asset classes, they are encouraged to disclose this.
11. The FRC encourages service providers to disclose how they carry out the wishes of their clients with respect to each principle of the Code that is relevant to their activities.
12. Signatories are encouraged to review their policy statements annually, and update them where necessary to reflect changes in actual practice.
13. This statement should be easy to find on the signatory's website, or if they do not have a website in another accessible form, and should indicate when the statement was last reviewed. It should include contact details of an individual who can be contacted for further information and by those interested in collective engagement. The FRC hosts on its website the statements of signatories without their own website.
14. The FRC retains on its website a list of asset owners, asset managers and service providers that have published a statement on their compliance or otherwise with the Code, and requests that signatories notify the FRC when they have done so, and when the statement is updated.
15. The FRC regularly monitors the take-up and application of the Code. It expects the content of the Code to evolve over time to reflect developments in good stewardship practice, the structure and operation of the market, and the broader regulatory framework. Unless circumstances change, the FRC does not envisage proposing further changes to the Code until 2014 at the earliest.

## Comply or Explain

1. As with the UK Corporate Governance Code, the UK Stewardship Code should be applied on a “comply or explain” basis.
2. The Code is not a rigid set of rules. It consists of principles and guidance. The principles are the core of the Code and the way in which they are applied should be the central question for the institutional investor as it determines how to operate according to the Code. The guidance recommends how the principle might be applied.
3. Those signatories that choose not to comply with one of the principles, or not to follow the guidance, should deliver meaningful explanations that enable the reader to understand their approach to stewardship. In providing an explanation, the signatory should aim to illustrate how its actual practices contribute to good stewardship and promote the delivery of the institution’s or its clients’ investment objectives. They should provide a clear rationale for their approach.
4. The Financial Services Authority requires any firm authorised to manage funds, which is not a venture capital firm, and which manages investments for professional clients that are not natural persons, to disclose “the nature of its commitment” to the Code or “where it does not commit to the Code, its alternative investment strategy” (under Conduct of Business Rule 2.2.3<sup>1</sup>).
5. The FRC recognises that not all parts of the Code are relevant to all signatories. For example, smaller institutions may judge that some of its principles and guidance are disproportionate in their case. In these circumstances, they should take advantage of the “comply or explain” approach and set out why this is the case.
6. In their responses to explanations, clients and beneficiaries should pay due regard to the signatory’s individual circumstances and bear in mind in particular the size and complexity of the signatory, the nature of the risks and challenges it faces, and the investment objectives of the signatory or its clients.
7. Whilst clients and beneficiaries have every right to challenge a signatory’s explanations if they are unconvincing, they should not evaluate explanations in a mechanistic way. Departures from the Code should not be automatically treated as breaches. A signatory’s clients and beneficiaries should be careful to respond to the statements from the signatory in a manner that supports the “comply or explain” process and bears in mind the purpose of good stewardship. They should put their views to the signatory and both parties should be prepared to discuss the position.

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<sup>1</sup> <http://fsahandbook.info/FSA/html/handbook/COBS/2/2>

## The Principles of the Code

So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.



# The UK Stewardship Code

## Principle 1

**Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.**

### Guidance

Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.

The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.

The statement should reflect the institutional investor's activities within the investment chain, as well as the responsibilities that arise from those activities. In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.

Where activities are outsourced, the statement should explain how this is compatible with the proper exercise of the institutional investor's stewardship responsibilities and what steps the investor has taken to ensure that they are carried out in a manner consistent with the approach to stewardship set out in the statement.

The disclosure should describe arrangements for integrating stewardship within the wider investment process.

## Principle 2

**Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.**

### Guidance

An institutional investor's duty is to act in the interests of its clients and/or beneficiaries.

Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

## Principle 3

### **Institutional investors should monitor their investee companies.**

#### **Guidance**

Effective monitoring is an essential component of stewardship. It should take place regularly and be checked periodically for effectiveness.

When monitoring companies, institutional investors should seek to:

- keep abreast of the company's performance;
- keep abreast of developments, both internal and external to the company, that drive the company's value and risks;
- satisfy themselves that the company's leadership is effective;
- satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members;
- consider the quality of the company's reporting; and
- attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

Institutional investors should consider carefully explanations given for departure from the UK Corporate Governance Code and make reasoned judgements in each case. They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position.

Institutional investors should endeavour to identify at an early stage issues that may result in a significant loss in investment value. If they have concerns, they should seek to ensure that the appropriate members of the investee company's board or management are made aware.

Institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.

Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.

## **Principle 4**

**Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.**

### **Guidance**

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the company's advisers;
- meeting with the chairman or other board members;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of General Meetings;
- submitting resolutions and speaking at General Meetings; and
- requisitioning a General Meeting, in some cases proposing to change board membership.

## **Principle 5**

**Institutional investors should be willing to act collectively with other investors where appropriate.**

### **Guidance**

At times collaboration with other investors may be the most effective manner in which to engage.

Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.

Institutional investors should disclose their policy on collective engagement, which should indicate their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure companies are aware of concerns. The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.

## **Principle 6**

**Institutional investors should have a clear policy on voting and disclosure of voting activity.**

### **Guidance**

Institutional investors should seek to vote all shares held. They should not automatically support the board.

If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records.

Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

Institutional investors should disclose their approach to stock lending and recalling lent stock.

## **Principle 7**

**Institutional investors should report periodically on their stewardship and voting activities.**

### **Guidance**

Institutional investors should maintain a clear record of their stewardship activities.

Asset managers should regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported and the format used, should be a matter for agreement between agents and their principals.

Asset owners should report at least annually to those to whom they are accountable on their stewardship policy and its execution.

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

Asset managers that sign up to this Code should obtain an independent opinion on their engagement and voting processes having regard to an international standard or a UK framework such as AAF 01/06<sup>2</sup>. The existence of such assurance reporting should be publicly disclosed. If requested, clients should be provided access to such assurance reports.

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<sup>2</sup> Assurance reports on internal controls of service organisations made available to third parties:  
<http://www.icaew.com/en/technical/audit-and-assurance/assurance/technical-release-aaf-01-06>



The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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## Lancashire County Pension Fund

### Compliance with the UK Stewardship Code - 2014

The UK Stewardship Code, which has been prepared by the Financial Reporting Council, sets out the principles of effective ownership by investors. In so doing, the Code assists institutional investors to better exercise their stewardship responsibilities.

The Financial Reporting Council encourages Institutional investors to report their compliance with the Code. This document summarises the approach of the Lancashire County Pension Fund to corporate governance and compliance with the Code.

Statement of Compliance with UK Stewardship Code	
<b>Principle 1 – Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.</b>	<p>Lancashire County Pension Fund takes its responsibilities as a shareholder seriously.</p> <p>The Fund believes that good corporate governance and the informed use of voting rights are an integral part of the investment process that will improve the performance of the companies in which the Fund is invested.</p> <p>Various policy documents are produced which identify how we meet our Stewardship responsibilities including our Statement of Investment Principles and Governance Compliance Statement.</p> <p>In practice the Fund's approach is to apply the Code both through its arrangements with asset managers and through membership of the Local Authority Pension Fund Forum (LAPFF). The Fund's asset managers take direct responsibility for stewardship issues in the funds that they manage on our behalf. Where these managers publish Statements of Compliance with the Stewardship Code, these are available on their respective websites or hosted by the FRC.</p> <p>The Fund seeks to use its position as a shareholder to actively encourage good corporate governance practice in those companies in which it invests. It does this by contracting the Pensions &amp; Investment Research Consultants Limited (PIRC) to provide a global service for a standard voting policy and casting of votes along with the provision of company research and reporting tools.</p>
<b>Principle 2 – Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.</b>	<p>Lancashire County Pension Fund encourages all its fund managers to have effective policies in place to address potential conflicts of interests. The need to avoid conflicts of interest is also highlighted in our investment manager mandates and contracts with external parties.</p> <p>In respect of conflicts of interests within the Fund, Committee members and officers are required to make declarations of interest at the start of all meetings and, depending upon the nature of the interest, may take no part in the particular decision. A public register of interests is also maintained for all Councillors.</p>
<b>Principle 3 –</b>	Day-to-day responsibility for managing the Fund's equity holdings is

<p><b>Institutional investors should monitor their investee companies.</b></p>	<p>delegated to the appointed fund managers, and the Fund expects them to monitor companies, intervene where necessary, and report back regularly on engagement activities.</p> <p>Lancashire County Pension Fund contracts with PIRC who provides a global service for standard voting policy and casting of votes along with the provision of company research and reporting tools. In addition the Fund receives an 'Alerts' service from the Local Authority Pension Fund Forum, which highlights corporate governance issues of concern at investee companies.</p>
<p><b>Principle 4 – Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.</b></p>	<p>As highlighted above, responsibility for day to day interaction with companies is delegated to the fund managers, including the escalation of engagement. Their guidelines for such activities are anticipated to be disclosed in their own statement of adherence to the Stewardship Code.</p> <p>Occasionally, the Fund may choose to escalate activity, principally through engagement activity through the Local Authority Pension Fund Forum. When this occurs, the Investment Panel will decide whether to participate in the proposed activity, consulting with the Chair as necessary.</p>
<p><b>Principle 5 – Institutional investors should be willing to act collectively with other investors where appropriate.</b></p>	<p>Lancashire County Pension Fund seeks to work collaboratively with other institutional shareholders in order to maximise the influence that it can have on individual companies.</p> <p>The Fund seeks to achieve this through membership of the Local Authority Pension Fund Forum (LAPFF) and National Association of Pension Funds (NAPF), which engages with companies over environmental, social and governance issues on behalf of its members.</p>
<p><b>Principle 6 – Institutional investors should have a clear policy on voting and disclosure of voting activities.</b></p>	<p>Lancashire County Pension Fund contracts with PIRC who provides a global service for a standard voting policy and casting of votes. The Pension Fund Committee have reviewed and agreed to adopt the voting guidelines of PIRC. These voting guidelines are regularly updated and publicly available on their website. PIRC provide a proxy voting service for all our global equity managers.</p>
<p><b>Principle 7 – Institutional investors should report periodically on their stewardship and voting activities.</b></p>	<p>Lancashire County Pension Fund annually reviews and updates its Statement of Investment Principles, which sets out the Fund's approach to responsible investing. The activity undertaken by PIRC and the Local Authority Pension Fund Forum is regularly made available to Committee.</p>



## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: None
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## **Outcome of the Socially Responsible Investment working group**

Appendices 'A' and 'B' refer

Contact for further information:

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Andrew.fox@lancashire.gov.uk

### **Executive Summary**

At its March 2014 meeting, the Pension Fund Committee requested that a Working Group be established to consider any issues and make recommendations to the Committee on the social and environmental impacts of the Fund's investment strategy and activity. The Working Group was asked to report to the Committee in Autumn 2014.

The Working Group met on three occasions and discussed a wide range of issues relating to Socially Responsible Investment/ Environmental, Social, and Governance areas. These focussed on requirements arising from the Committee's fiduciary duty to beneficiaries and recent studies in this area, as well as examining the activities currently undertaken by the Fund in this area, and proposals for further activity.

An action plan has been developed to progress the recommended actions, which is attached as Appendix B.

### **Recommendation**

The Committee is requested to consider the report and proposals of the Socially Responsible Investment Working Group and to determine future direction in this area.

### **Background and Advice**

At its meeting on 27 March 2014, the Pension Fund Committee considered a report on proposals to commission advice in relation to various issues relating to the broader social and environmental impacts of the Pension Fund's investment activities.

The proposal was in response to the Notice of Motion carried by Full Council on 12 December 2013. The Notice of Motion asked officers to undertake work aimed at examining potential routes to increase the level of environmental and social

responsibility of invested companies and to examine the barriers to a policy of active divestment in areas which would appear to be in conflict with the County Council's broader policy agenda.

It was suggested that the Committee establish a small task and finish group to review the scope of the project and to undertake the work. The task and finish group would aim to report back in autumn 2014.

The Socially Responsible Investment working group was subsequently established, and comprised the following members of the Committee:

- County Councillor M Parkinson - Chair;
- County Councillor M Brindle;
- County Councillor G Dowding;
- County Councillor D Westley;
- Councillor R Whittle, Blackburn with Darwen Borough Council.

The Group met on 23 July 2014, 9 September 2014, and 20 October 2014.

### **Summary of matters discussed and related outcomes**

The following areas formed the main areas of debate:

- Fiduciary duty;
- Existing investment activity;
- Governance and policy;
- Analysis and monitoring.

#### *Fiduciary duty*

The attention of the Working Group was drawn to a Counsel's opinion secured by the LGPS Shadow Advisory Board and in particular the view that "The administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the fund (balancing risk and return in the normal way)". The opinion added that "So long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund. In taking account of any such considerations, the administering authority may not prefer its own interests to those of other scheme employers, and should not seek to impose its particular views where those would not be widely shared by scheme employers and members."

The Working Group noted the Law Commission's view that trustees should take account of financially material risks and that non-financial factors may also be taken into account subject to the following two tests being met:

- Trustees should have good reason to think that scheme members would share the concern; and

- The decision should not involve a risk of significant financial detriment to the fund.

The Law Commission also advised that trustees may not impose their own ethical views on their beneficiaries

There was also a discussion on the implications of this advice and the Working Group welcomed the clarification which the Law Commission and Counsel's Opinion had given to the role and duties of trustees when setting an investment strategy.

*Outcomes:*

- 1. Having considered all the information presented to its meetings, the Working Group agreed that it would wish to recommend the Pension Fund Committee to consider a more active stance in relation to responsible investment issues than had previously been the case where that did not pose the risk of financial detriment to the Fund. Members acknowledged that the primary aim of an investment strategy was to secure the best possible return and that the administering authority and trustees should not impose their own ethical views on issues such as tobacco, energy, food etc., on scheme beneficiaries.**
- 2. Concerns were expressed about the Fund's ability to canvass and assess the views of scheme employers and members on specific social, ethical and environmental considerations and investments. Before taking any specific steps that could potentially lead to the investment in or disinvestment from particular sectors, Members acknowledged that it was important to canvass and understand the views of scheme stakeholders, and agreed that different ways of achieving this needed to be explored.**
- 3. The Working Group felt that it now had a much greater understanding of SRI and ESG issues and in particular the legal framework around fiduciary duties and the issue of disinvestment. Members again acknowledged that the primary aim of the Fund's investment strategy was to secure the best possible return and it was agreed that disinvestment was not an option which should be pursued by the Fund at this moment.**

This enhanced understanding has led to a recognition of definitional differences between 'responsible investment (RI)' and 'socially responsible investment'.

Outcome 3 above demonstrates that the Fund is seeking to pursue an RI approach rather than a SRI approach, as defined by the National Association of Pension Funds (NAPF):

*Responsible Investment is an investment approach in which investors recognise the importance of the long-term health and stability of the market as a whole; seeking to incorporate material extra-financial factors alongside other financial performance and strategic assessments within investment decisions; and utilise ownership rights and responsibilities attached to assets to protect*

*and enhance shareholder value over the long term – primarily through voting and engagement.*

SRI is defined as an investment approach that combines investment returns with moral or ethical roles that are not generally driven by financial considerations. It involves the exclusion of so-called 'sin stocks' regardless of their financial performance, but also seeking to achieve social and environmental objectives. The outcomes above demonstrate the Working Group's view that such an approach is not desirable or appropriate for the Fund.

Accordingly, the term 'responsible investment' (rather than socially responsible investment) will subsequently be used in this report to refer to the investment approach.

#### *Existing investment activity*

The Working Group reviewed the Fund's current investments in the context of ESG considerations. While there were a significant range, particularly of clean energy investments of various types officer emphasised the fact that these investments had been identified based on the Fund's desire to have a diverse investment portfolio but more importantly the anticipated long term financial return. Social, ethical and environmental considerations had not played any part in the decision making and the Working Group noted that this reflected how the primary consideration of securing the best possible return was linked to investments which could be considered "ethical" or "socially responsible".

#### *Outcome:*

- 4. The Working Group encouraged the taking of specific steps or actions to reduce carbon production within the Fund's portfolio - for example, within the property portfolio. In addition, the Group supported the continued identification of good investment opportunities and the making of investments that provide appropriate returns and which may possess certain 'green' or clean energy characteristics.**

#### *Governance and policy*

There was a discussion around the Environment Agency's move towards environmental investments which had achieved a return above benchmark. It was suggested that the Fund should look at best practice models of RI including the EA's investment strategy. The EA and several other Funds had also signed up to the UN-backed Principles for Responsible Investment and it was felt that the Lancashire County Pension Fund should also work towards the adoption of the UN's principles:

*Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.*

*Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.*

*Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.*

*Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.*

*Principle 5: We will work together to enhance our effectiveness in implementing the Principles.*

*Principle 6: We will each report on our activities and progress towards implementing the Principles.*

Details were discussed of the approach undertaken by the Environment Agency, which was arguably the most advanced LGPS fund in terms of developing a responsible investing approach. In addition, the responses of 19 members of the CIPFA Pensions Network to questions around ethical investment policies were circulated and discussed.

In order to promote accountability through transparency, the Group felt that more could be done to set out the Fund's beliefs in this area and by doing so sending an explicit message as to the seriousness of its intent. In this context adopting an external standard such as the UN Principles would provide a basis for measuring progress.

*Outcome:*

**5. The Working Group recommend the adoption by the Fund of a Responsible Investment Policy based on the Policy Tool produced by UNPRI, and subsequently work towards the adoption of the UN Principles.**

It was felt that the advice and guidance of the Law Commission and Counsel's opinion gave the Pension Fund Committee a degree of flexibility to consider its own position and the direction of travel it might wish to adopt in respect of responsible investment. Any moves towards responsible investment would need to be embedded in the Fund's statement of investment principles (SIP), investment strategy, asset allocation, fund manager selection and performance monitoring.

The current version of the Fund's Statement of Investment Principles, approved by the Pension Fund Committee in March 2014, contains the following paragraphs relating to ESG issues:

## **Social, Environmental and Ethical Considerations**

*The Fund takes an active stance on corporate governance issues. It uses Pensions Investment Research Consultants ("PIRC") to vote on its behalf at shareholder meetings. PIRC advises on Socially Responsible Investment issues and issues voting guidance and commentary for shareholder meetings. PIRC is instructed to vote the Fund's shares in accordance with its guidelines unless an Investment Manager requests a different vote for investment management reasons. In the latter case, the Treasurer to the Fund will decide how best to cast the vote in the long-term financial interest of the Fund.*

*The Fund is a member of the Local Authority Pension Fund Forum ("LAPFF"), which is a group of like-minded local authority pension funds that meet to discuss and act / engage in respect of Socially Responsible Investment and Corporate Governance issues.*

### **6. A proposal for revised responsible investment wording within the SIP should be produced.**

In advance of revised wording arising from the development of a Responsible Investment policy, proposed wording to enhance the Fund's stance in this area is attached as Appendix A for consideration.

In terms of influence and engagement, the Group agreed that the influencing of behaviour relating to ESG considerations through LAPFF and PIRC continued to be important. It was noted that LAPFF would welcome the opportunity to engage more effectively with members of the Committee including the attendance of members at its meetings. The Group welcomed the prospect of senior representatives of both LAPFF and PIRC being scheduled to present to the November 2014 meeting of the Committee, and to hear what both organisations do on the Fund's behalf and what more could be done to increase engagement.

### *Analysis and monitoring*

In wishing to be a good asset owner, and promote transparency and accountability – the adoption of an analysis tool or model (such as those developed by Northern Trust and Robeco) to measure carbon footprints and risks, and/or environmental, social and governance (ESG) issues across the Fund's portfolio was discussed.

Whilst not advocating a move away from unconstrained equity mandates, the Group felt that ESG issues should form a more structured element of the ongoing discussions that the Fund has with its external managers. Such discussions may be helped, but not dependent upon, the procurement of an appropriate monitoring tool.

*Outcomes:*

- 7. Investigate the options for procuring/ signing up to an ESG monitoring tool/ service.**
- 8. Formalise ESG discussions with external investment managers as part of ongoing engagement.**

## **Consultations**

N/A

## **Implications:**

This item has the following implications, as indicated:

## **Risk management**

No significant risks have been identified in relation to this report.

## **Local Government (Access to Information) Act 1985 List of Background Papers**

Paper	Date	Contact/Directorate/Tel
Report to the SRI Working Group – 9 September 2014	September 2014	Andrew Fox/ County Treasurer's Directorate/ 01772 535916
National Association of Pension Funds (NAPF) Responsible Investment Guide	2013	Andrew Fox/ County Treasurer's Directorate/ 01772 535916

Reason for inclusion in Part II, if appropriate

N/A



## Corporate Governance and Responsible Investment

### Corporate Governance

The Fund recognises its responsibility as an institutional investor to support and encourage good corporate governance practices in the companies in which it invests. The Fund considers that good corporate governance can contribute to business prosperity by encouraging accountability between boards, shareholders and other stakeholders. Good corporate governance also plays a major role in encouraging corporate responsibility to shareholders, employees and wider society.

### The Fund's approach to Corporate Governance

The Fund has a longstanding policy of supporting good corporate governance in the companies in which it invests, and challenging companies who do not meet the standards or reasonable expectations set by their peers.

In order to fulfil this responsibility, the Fund communicates with companies and exercises the rights (including the voting rights) attaching to investments in support of its corporate governance policies. The Fund's voting rights are an asset and will be used to further the long-term interests of the Fund's beneficiaries. As a general principle, votes will be used to protect shareholder rights, to minimise risk to companies from corporate governance failure, to enhance long-term value and to encourage corporate social responsibility.

The Fund may utilise some or all of the following tools: writing to company management; special meetings with companies; questions and discussions with companies at routine meetings and AGMs; joining in or supporting campaigning or pressure groups; issuing public statements/ briefings; and proxy voting.

### Responsible Investment

Responsible Investment is an investment approach in which investors recognise the importance of the long-term health and stability of the market as a whole; seeking to incorporate material extra-financial factors alongside other financial performance and strategic assessments within investment decisions; and utilise ownership rights and responsibilities attached to assets to protect and enhance shareholder value over the long term – primarily through voting and engagement. The objective of responsible investment is decreasing investor risk and improving risk-adjusted returns.

Examples of potentially material risks to be considered as part of the Fund's voting and engagement activity are set out below:

#### *Governance risks:*

- Board independence – Non-Executive Directors play a vital role in overseeing the executive management and safeguarding the interests of shareholders;
- Succession planning – An ineffective policy can have implications for a company's performance, including uncertainty over its sustainability;
- Board diversity – Research suggests that shareholders, companies and boards are not best served by an overly homogenous board prone to group think;
- Auditors – The independence of auditors plays a crucial role in protecting shareholders.

### *Environmental risks:*

- High intensity industries will incur additional financial costs from carbon regulations in different jurisdictions. Changes in climate will affect company supply chains and fixed assets;
- Energy use – Through effective management of energy use, companies are able to reduce energy costs as well as build security of supply;
- Natural resources – Demand for raw materials is ever increasing, this has implications including increasing regulation around sourcing and use of resources;
- Water – A growing global population is leading to rising consumption – this in turn increases costs and creates tensions or conflicts.

### *Social risks:*

- Human rights – Companies operating in companies with poor human rights records may face significant challenges, such as legal challenges or reputational damage;
- Employment – Research indicates that well managed employee relations improve worker productivity and effectiveness in turn benefitting shareholders;
- Health and safety – Companies with poor health and safety records may face prosecutions, fines and in extreme cases, the withdrawal of licences to operate;
- Supply chain – Companies are increasingly reliant on a large, global workforce, exposing them to increased risks of disruptions.

Implementing a responsible investment policy helps a pension fund to adhere to the UK Stewardship Code. The Fund's current position relating to the UK Stewardship Code can be found in a separate statement on its website.

Lack of good governance interferes with a company's ability to function effectively and is a threat to the Fund's financial interest in that company.

### **The Fund's approach to responsible investment**

The Fund's approach to responsible investment divides into four areas of activity.

#### *a) Voting Globally*

The first approach, voting, is certainly not a 'boxticking' exercise, as the Fund regularly votes against resolutions. The Fund, through a proactive voting policy, in partnership with PIRC, votes its share rights constructively based upon a comprehensive analysis of company voting issues.

PIRC is instructed to vote the Fund's shares in accordance with its guidelines unless an Investment Manager requests a different vote for investment management reasons. In the latter case, the Treasurer to the Fund will decide how best to cast the vote in the long-term financial interest of the Fund.

#### *b) Engagement through Partnerships*

The Fund's second approach involves working in partnership with like-minded bodies. The Fund recognises that to gain the attention of companies in addressing governance concerns, it needs to join other investors with similar concerns. It does this through:

- Local Authority Pension Fund Forum (LAPFF);
- Voting on shareholder resolutions;
- Joining appropriate lobbying activities.

In terms of its engagement approach with other investors, it is most significant through LAPFF. This Forum exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social

responsibility and high standards of corporate governance among the companies in which they invest. See the LAPFF website for further details: [www.lapfforum.org](http://www.lapfforum.org)

### *c) Shareholder Litigation*

The third approach, adopted by the Fund in order to encourage corporate management to behave responsibly and honestly, is through shareholder litigation. The Fund, in partnership with two US law firms and other shareholders, submits class actions globally where possible and where appropriate.

### *d) Active Investing*

The fourth and most challenging activity for the Fund in this particular field is actively seeking investments with ESG characteristics, provided these meet the Fund's requirements of strong returns combined with best practice in ESG and/or corporate governance. Such investments include alternative energy, clean energy, shared ownership housing.

The Fund will continue to develop its approach in promoting effective corporate governance and socially responsible investment wherever possible, including working towards certain recognised standards in order to increase transparency and accountability.

## Proposed Action Plan arising from RI Working Group

Area	Option	Resources	Direct Cost £	Timescale	Ease to achieve	Priority
<b>Fiduciary duty</b>						
<p>Outcome 1</p> <p>Having considered all the information presented to its meetings, the Working Group agreed that it would wish to recommend the Pension Fund Committee to consider a more active stance in relation to RI issues than had previously been the case where that did not pose the risk of financial detriment to the Fund. Members acknowledged that the primary aim of an investment strategy was to secure the best possible return and that the administering authority and trustees should not impose their own ethical views on issues such as tobacco, energy, food etc., on scheme beneficiaries.</p>						
Action 1	Recommendation to Pension Fund Committee to consider a move towards RI where it was practicable to do so, and without posing a detrimental financial risk to the Fund.	Officer time	None	Subsequent meeting of the Pension Fund Committee	Easy	High
<p>Outcome 2</p> <p>Concerns were expressed about the Fund's ability to canvass and assess the views of scheme employers and members on specific social, ethical and environmental considerations and investments. Before taking any specific steps that could potentially lead to the investment in or disinvestment from particular sectors, Members acknowledged that it was important to canvass and understand the views of scheme stakeholders, and agreed that different ways of achieving this needed to be explored.</p>						
Action 2	A policy setting out the circumstances in which stakeholder consultation would be sought and the possible methods for achieving this should be developed.	Officer time	None	31 December 2014	Moderate	Low
<p>Outcome 3</p> <p>The Working Group felt that it now had a much greater understanding of RI, SRI and ESG issues and in particular the legal framework around fiduciary duties and the issue of disinvestment. Members again acknowledged that the primary aim of the Fund's investment strategy was to secure the best possible return and it was agreed that disinvestment was not an option which should be pursued by the Fund at this moment.</p>						
Action 3	None.					
<b>Existing investment activity</b>						
<p>Outcome 4</p> <p>The Working Group encouraged the taking of specific steps or actions to reduce carbon production within the Fund's portfolio - for example, within the property portfolio. In addition, the Group supported the continued identification of good investment opportunities and the making of investments that provide appropriate returns and which may possess certain 'green' or clean energy characteristics.</p>						
Action 4	Reduce carbon footprint of LCPF property portfolio wherever possible	Specification/ procurement/ installation	Dependent on options	Ongoing	Difficult	Medium

Area	Option	Resources	Direct Cost £	Timescale	Ease to achieve	Priority
<b>Governance and policy</b>						
Outcome 5 The Working Group recommend the establishment by the Fund of a Responsible Investment Policy based on the Policy Tool produced by UNPRI, and subsequently work towards the adoption of the UN Principles.						
Action 5a	Create a Responsible Investment Policy for the Fund	Officer time	None	By 31 December 2014	Easy	High
Action 5b	Consider signing up to the UN PRI initiative	Officer time Ongoing compliance	£5,640 p.a.	Sign up by 31 March 2015	Sign-up – easy Monitoring - moderate	Medium
Outcome 6 A proposal for revised SRI wording within the SIP should be produced.						
Action 6	Rewrite Statement of Investment Principles section on RI/ ESG	Officer time	None	Immediate – proposal attached as Appendix B	Easy	High
<b>Analysis and monitoring</b>						
Outcome 7 Investigate the options for procuring/ signing up to an SRI/ ESG monitoring tool/ service.						
Action 7	Procure/ sign up to RI/ ESG monitoring tool/ service eg RobecoSAM	Officer time	Details awaited	By 31 March 2015	Moderate	Medium
Outcome 8 Formalise SRI/ ESG discussions with external investment managers as part of ongoing engagement.						
Action 8	Create structured framework for ongoing discussions with external investment managers.	Officer time	None	By 31 December 2014	Easy	Medium



## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: <u>All</u>
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## **Interim Administration Report**

(Appendix A refers)

Contact for further information:

Diane Lister, 01772 534827, Office of the Chief Executive,

diane.lister@lancashire.gov.uk

### **Executive Summary**

An interim administration performance report has been produced following the introduction and implementation of the new LGPS 2014 from 1 April 2014. The report indicates that service delivery has been maintained throughout the period of change.

### **Recommendation**

The Committee is asked to note the report as set out at Appendix 'A'

### **Background and Advice**

An interim administration performance report has been produced following the introduction and implementation of the new LGPS 2014 from 1 April 2014 (Appendix 'A' refers). The report sets out performance against standards and targets as defined in a Service Level Agreement with Your Pension Service.

The report indicates that annual events have been completed on time and that performance against targets has been maintained during the period from 1 April to 30 September 2014. Only one area of work was adversely impacted by the implementation of the new LGPS 2014 and this was as a result of the late receipt of revised transfer factors from the Government Actuary's Department (GAD).

The Service's new data collection portal has been successfully implemented to cater for the monthly collection of Career Average Revalued Earnings (CARE) data. Work is ongoing to ensure the successful submission of monthly data files from employing organisations. A progress report will be included in an annual administration report to be presented to the Committee at its meeting of 5 June 2015.

Overall the report presented at Appendix 'A' indicates that service delivery has been maintained during this period of change.

**Consultations**

N/A

**Implications:**

N/A

**Risk management**

N/A

**Local Government (Access to Information) Act 1985  
List of Background Papers**

Paper	Date	Contact/Directorate/Tel
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N/A

Reason for inclusion in Part II, if appropriate

N/A



# LANCASHIRE COUNTY PENSION FUND

6 month Interim Administration  
Performance Report  
1 April - 30 Sept 2014























































































# 1. INTRODUCTION

## Purpose

This 6 month interim performance report has been produced as an update following the introduction and implementation of the new LGPS 2014, effective from 1 April 2014.

## Annual Plan – 2014/15

 Due  Completed

Event	Responsibility Your Pension Service (YPS)											
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Application of Pension Increases												
Issue Annual Benefit Statement to Active Members												
Issue Annual Benefit Statement to Def Members												
Issue P60s to Pensioners												
Issue Newsletter												
Complete HMRC Scheme Returns												
Provide FRS17 data												

## 2. PERFORMANCE

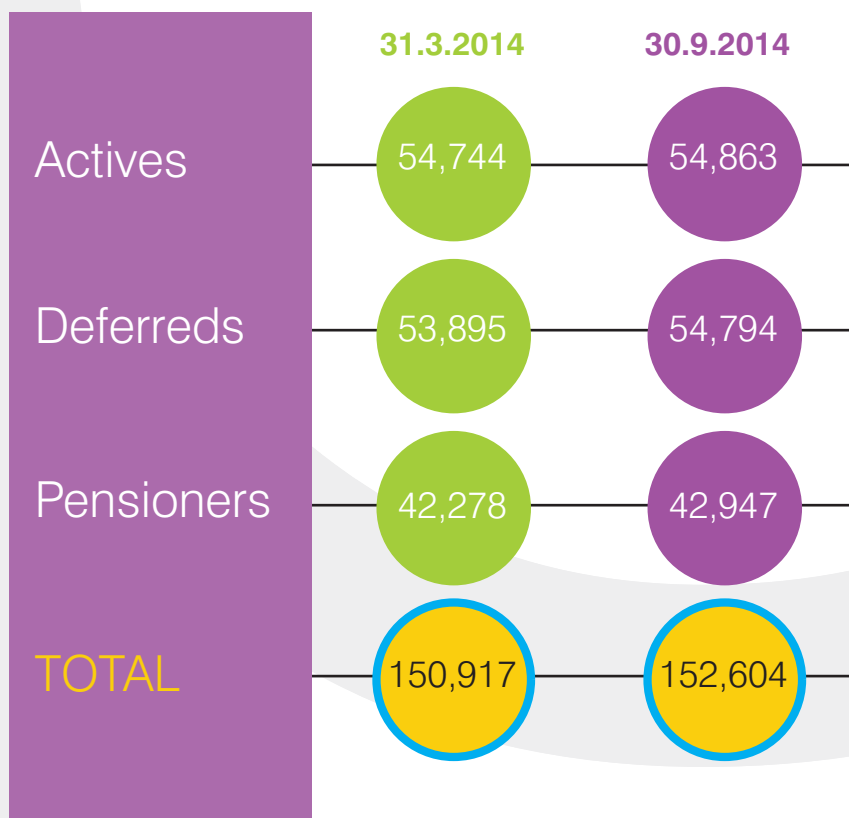
### Annual Benefit Statements

Over the period the service produced over 100,000 online benefit statements for active and deferred Scheme members. Annual newsletters were posted online alongside the statements. Email alerts were also sent to Scheme members who had signed up to "My Pension Online" to promote the Pension Surgeries. Over 11,400 active and deferred members have signed up to My Pension online

### Membership

As a result of the Probation Transfer, 548 actives and 280 deferred pensioners left in this period. A total of 456 pensioners transferred in early November completing the Probation transfer.

## LGPS



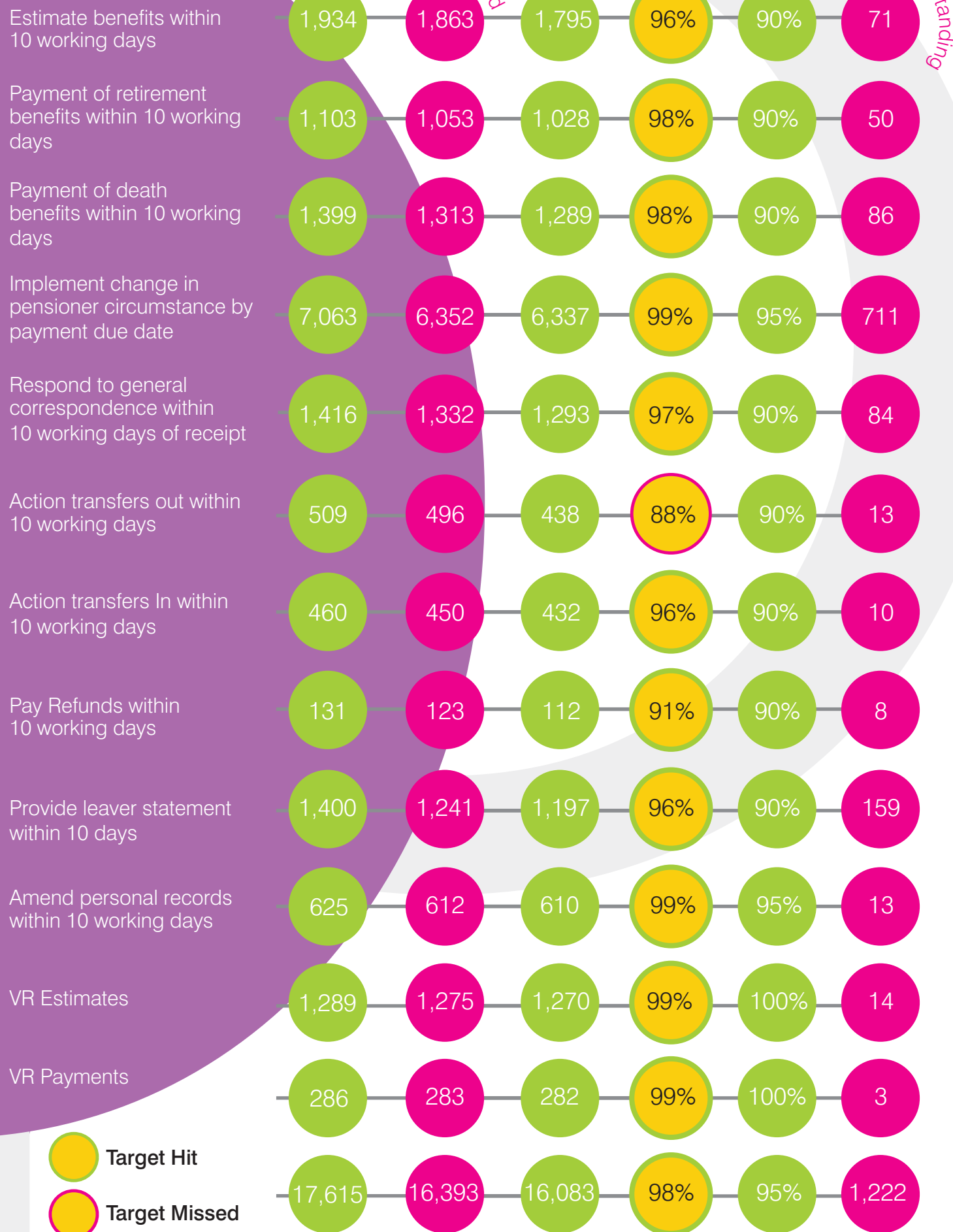
### Performance

Performance continues to exceed SLA targets and the Service consistently exceeds its key performance indicator; 'to calculate and pay all retirement benefits within 10 working days'. Overall achievement against SLA targets over the year was 98%. Performance in respect of transfers was adversely affected by the late receipt of revised factors from the Government Actuary's Department (GAD).

During the reporting period, 16,393 individual calculations/enquiries were completed, of which 16,083 met the performance standard; an overall performance of 98% was achieved.

## LGPS

### Performance Standard



## 3. CUSTOMER SERVICE

### Partnership Events

During the Period the Service's dedicated Partnerships Team undertook a variety of events, courses and presentations. In addition the Team visited 25 employers to maintain and improve working relationships and to assist employers with their understanding of the new LGPS 2014 requirements.

### AskPensions

A dedicated pension's helpdesk is the first point of contact for both Scheme members and employers. Over the year 97% of calls were successfully answered, exceeding the SLA of 90%.

## 4. ADMISSIONS

### During the 6 month period:

- 16 new admission agreements were approved
- 30 new admissions were awaiting approval

Of the 16 new approved and finalised admissions:

- The largest admission agreement covered 93 staff employed by Burnley Leisure (sponsored by Burnley Borough Council)

- 14 covered catering or cleaning staff in schools and academies
- 1 covered catering staff sponsored by Lancashire fire and Rescue Service

The 30 outstanding admissions are at various stages of the admissions process and the majority relate to schools outsourcing.

## 5. APPEALS

Members who disagree with decisions taken by their employer or administering authority may appeal using the Internal Dispute Resolution Procedure (IDRP) under the LGPS rules.

The IDRP is a formal appeal procedure which contains two stages. The first stage allows the person to ask the body who originally made the decision to review it, i.e. either the employer or the administering authority. The second stage allows the person, if they are not satisfied with the outcome at the first stage, to ask the

Appeals Office at the administering authority to review the disagreement. The Appeals Officer for Lancashire County Council is the Deputy County Treasurer.

During the Period 9 second stage appeals were received. The Appeals Officer has dismissed 7 and upheld 1 of these appeals with 1 currently ongoing.

The majority of appeals relate to ill health retirement.

## 6. e-DEVELOPMENT

### EPIC Update

**Your Pension Service (YPS) introduced a new data collection system in April 2014. This is called the “Employer Pension Information Collection” system (EPIC).**

In response to the new LGPS 2014, EPIC collects Career Average Revalued Earnings (CARE) data on a monthly basis in order to ensure that:

- Member data is accurate, consistent and up to date
- Contributions are reconciled on a monthly basis
- Employers have complied with the requirements of the new LGPS 2014
- Members who have registered online can see their CARE pension pot ‘grow’

Employers/payroll providers have been asked to submit a data collection file each pay period, from which CARE pay data and contributions data is uploaded to the pension administration system; Altair. New starter information and amendments are also uploaded from the files submitted. Prior to the introduction of the new LGPS 2014, Your Pension Service provided significant support and training to assist employers in meeting their new responsibilities.

As of the end of October 2014, files have been successfully submitted covering 94% of the Fund’s active membership.

Unfortunately some employers/payroll providers have not submitted any files since April 2014. These non-submissions cover approximately 6% of the Fund’s active membership. (This involves 53 employers, 31 of which employ less than 10 scheme members).

For employers who have not submitted any files, this means that new starters and amendments from 1 April 2014 have not been identified, and new Scheme CARE pay data and contributions data has not been uploaded to member records on Altair.

A significant amount of resource has been dedicated to contacting, chasing and offering support to the employers/payroll providers who have not submitted files. The YPS Data Management Team and Partnerships Team have worked together to provide support in order to encourage and assist employers in the implementation of our new data collection requirements.

However, in the continued absence of data files, the County Treasurer has now written formally to employers concerned to inform them that their payroll providers have not submitted the information required by the Fund. Employers have been given a deadline of 31 January 2015 to comply with the Fund’s requirements which are set out in the Pensions Administration Strategy Statement (PASS). All employers are asked to sign up to the PASS. Further support has been offered, particularly for smaller employers where it is recognised that new system requirements may be problematic.

From 1 April 2015, the Pensions Regulator will assume new powers in respect of public sector schemes. Guidance received to date suggests that more robust data quality reporting requirements will be required from public sector pension schemes, and their employing organisations, going forward. Therefore, from 1 April 2015 Your Pension Service will monitor monthly data collection and will introduce performance targets for employers. Employers have been informed

that they should submit data collection files by 6th of the month following the payroll period end date. YPS will monitor receipt of employer files and report employers that fail to meet the deadline. Files submitted by 6th of the month will be reconciled against contributions paid by 19th of the month following payroll period

end and these data submissions will be fully uploaded to Altair by the last working day of the month following payroll period end.

Performance against these targets will be reported to the Pension Fund Committee.

## 7. CHARGES

Your Pension Service makes a charge to the Pension Fund on a per member basis which is restricted to the lower quartile as reported in national benchmarking returns. This charge is currently set at £21.50 per member as against a benchmark of £23.00. The ongoing level of charge to the Fund will be kept under review.

Despite the increased workload due to the implementation of the new LGPS, this unit cost is not expected to rise. This is due to a continued focus on efficiency, in particular the use of online services.





## **Pension Fund Committee**

Meeting to be held on 28 November 2014

Electoral Division affected: All
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### **Feedback on External Pension Fund Training Events Attended by Members** (Appendices 'A' and 'B' refer)

Contact for further information:

Chris Mather, (01772) 533559, Office of the Chief Executive,

[Chris.mather@lancashire.gov.uk](mailto:Chris.mather@lancashire.gov.uk)

#### **Executive Summary**

This reports provides feedback on external Pension Fund training events attended by members of the Committee

#### **Recommendation**

The Committee is asked to note the report.

#### **Background and Advice**

The Pension Fund Committee at its meeting on 29 November 2013 approved a training plan for members of the committee. The purpose of the plan is to ensure best practice within the Fund, and to comply with the Public Service Pensions Act 2013. Members and officers are also required to undertake training to satisfy the obligations placed upon them by the:

- Myners Principles (as detailed in the Statement of Investment Principles);
- Pensions Regulations and the Pensions Regulator;
- CIPFA Code of Practice on Public Sector Pensions Finance Knowledge and Skills; and the
- LGPS Governance Compliance Statement.

The training plan requires members to provide verbal feedback at the subsequent committee meeting to cover:

- Their view on the value of the event and the merit, if any, of attendance;
- A summary of the key learning points gained from attending the event; and
- Recommendations of any subject matters at the event in relation to which training would be beneficial to committee members.

The following external training events have been attended by members since the last meeting of the committee:

- 18 September 2014 - CIPFA Pensions Network "Introduction to the Local Government Pension Scheme". A copy of the event programme is attached at Appendix 'A'. The event was attended by County Councillors Lorraine Beavers and Keith Sedgewick; and
- 1 October 2014 – 33 Consulting Elected Member Educational Event. A copy of the event programme is attached at Appendix 'B'. The event was attended by County Councillors David Borrow and Barrie Yates.

Feedback on the external training events will be provided by the members at the meeting.

### **Consultations**

N/A

### **Implications:**

This item has the following implications, as indicated:

### **Risk management**

Without the required knowledge and skills, those charged with governance and decision-making within the Pension Fund may be ill-equipped to make informed decisions regarding the direction and operation of it.

### **Financial**

The cost of members attending the external training events was met by the Pension Fund.

### **Local Government (Access to Information) Act 1985 List of Background Papers**

Paper	Date	Contact/Directorate/Tel
Scheme of Delegation items		Chris Mather, OCE 01772 533559
Reason for inclusion in Part II, if appropriate		
N/A		

## CIPFA Pensions Network

### Introduction to the LGPS

***For the first time in one day the CIPFA Pensions Network will offer a training event to capture all of the key aspects involved in managing a Local Government Pension Fund. Aimed at new or inexperienced Officers and Elected Members this course, based on the CIPFA Knowledge & Skills Framework, will provide an insight into the wide range of different professional disciplines which impact on the LGPS including Actuaries, Accountants, Auditors, Custodians and Investment Advisers and will also cover all of the legal and regulatory requirements and highlight the importance of good governance when charged with responsibility of operating a Public Sector Pension Fund.***

***In the impressive surroundings of State Street's London Offices this event will be an informative yet informal way of increasing understanding in a range of topics whilst also allowing delegates to network with colleagues and industry experts to enhance the learning experience.***

18th September 2014 London

Sponsored by State Street Global Advisers

09.30 – 10.00	Coffee and Registration
10.00 – 10.05	Introductions & Welcome – Gerard Moore, CIPFA Associate
10.05 – 10.45	<p><i>What is the Local Government Pension Scheme (LGPS)? Neil Sellstrom, Lead Pensions Advisor, CIPFA</i></p> <p><b><i>Starting at the beginning this session will explain the basics of the LGPS, the various roles and responsibilities, the legal and regulatory framework and the governance requirements for Funds, Administering Authorities, Officers and Elected members.</i></b></p>
10.45 – 11.25	<p><i>Triennial Valuations and Understanding Liabilities – Ian Kirk, Mercer</i></p> <p><b><i>Understand the importance of the Valuation process and how the Actuary views the liabilities of Pension Funds and what assumptions they need to consider. How can liability risks be measured and monitored and what should Scheme Employers expect from the Actuary and Pension Fund.</i></b></p>
11.25 – 11.45	Break and Networking
11.45 – 12.15	<p><i>Accounting and Audit Requirements – Neil Sellstrom, CIPFA</i></p> <p><b><i>This session will be a trip around the various accounting regulations and codes to identify the requirements of financial reporting under the new International Financial Reporting Standards (IFRS) and the implications for and role of Auditors in providing assurance to those with responsibilities.</i></b></p>

12.15 – 12.35	<p><i>Basics of Asset Allocation – State Street Global Advisors</i></p> <p><i>Marcus Schulmerich – Global Portfolio Strategist</i></p> <p><b><i>What are the tools and products Pension Funds use to invest Funds in an appropriate way? How are the Liabilities used as a basis for determining asset allocation and how are the various investment products combined to manage risk and deliver the required returns over the long term?</i></b></p>
12.35 – 13.15	<p><i>Developing Investment Strategies – State Street Global Advisors</i></p> <p><i>Marcus Schulmerich – Global Portfolio Strategist</i></p> <p>How do Pension Funds construct and manage an investment portfolio? What are the various financial instruments and how are they used to generate returns and protect capital value within acceptable levels of risk?</p> <p>Introduction to key investment themes including portfolio diversification, asset class correlations, portfolio management, risk and reward, liability matching, and the role of the asset manager.</p>
13.15 – 14.05	<b>Lunch and Networking</b>
14.05 – 14.35	<p><i>Role of the Global Custodian – State Street Global Services</i></p> <p><i>Mark Janaway – Client Executive, David Cullinan – Consultant State Street Investment Analytics</i></p> <p><b><i>Who are Custodians and why do Pension Funds need them? What services can they provide to support Funds and enhance services?</i></b></p>
14.35 – 15.05	<p><i>Institutional Investors and Corporate Governance – Gerard Moore</i></p> <p>With assets of over £130bn in value the LGPS has an important role on behalf of its members to manage these assets effectively not only to enhance their value but to promote responsible behaviour and actions in the corporate sector. Hear about Proxy Voting, Securities lending and the Stewardship Code.</p>
15.05 – 15.20	<i>Break and Networking</i>
15.20 – 16.00	<p><i>Round up of current issues affecting public sector pensions</i></p> <p>The final session of the day will pull together a range of current initiatives plus a brief outline of the changes ahead for the LGPS. We will touch on efficient procurement, the governance agenda and the role of CIPFA's Knowledge &amp; Skills Framework – plus a chance to discuss other relevant issues with colleagues.</p>
16.00 – 16.15	<b>Final discussions and close</b>

*The facilitators for this event will be Neil Sellstrom, Pensions and Treasury Management Advisor & Gerard Moore, CIPFA Associate*



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## Invitation

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(C) Imperial War Museum

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### **Elected Member Educational Event (EMEE)**

**HMS Belfast**  
**Queens Walk • Tooley Street •**  
**London • SE1 2JH**

**Wednesday 1st October 2014**

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I wanted to let you know that I will be holding the second 330 Consulting Elected Member Educational Event (EMEE) in the *Ship's Company Dining Hall on board HMS Belfast* in London on **Wednesday 1st October 2014**. The event is designed for those members of Pensions Committees who are relatively new to their roles, but it is also open to other, more experienced, Committee members who would like a refresher on some key investment concepts and issues. Officers are also very welcome to attend the event.

Whilst the consultation process by the DCLG on the 'passive vs active' approach for listed investments remains ongoing, it seems that Fund mergers are off the table, and so Elected Members and Officers will continue to have the responsibility for taking local decisions relating to investment strategy and investment managers for their fund. My hope in running EMEE events is that attendees can benefit from presentations on investment topics that do not assume a detailed understanding of the investment world, and yet which provide a good grounding in each topic to help attendees in their duties back in the real world.

To help keep the day interesting, and not make it too focussed on investment topics, the EMEE will again be a mixture of educational investment sessions and politically-themed presentations. The current agenda is set out below.

Those interested in attending can register for the event simply by emailing me at [david@330consulting.com](mailto:david@330consulting.com), or via the 'Events' section on my website at [www.330consulting.com](http://www.330consulting.com)

I hope that my event will be of interest to representatives of your Fund, and I look forward to seeing some of them in October. If you have any questions on the event itself, do please get in touch,

Kind regards

*David Crum*  
*Director, 330 Consulting*

## Event sponsored by



## Agenda

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08:30 - 09:15      **Registration and Coffee**

09:15 - 09:25      **Welcome**

David Crum, Owner, 330 Consulting

I will take a few moments to welcome everyone to the event, set out the plan for the day, and deal with any pertinent housekeeping issues.



09:25 - 10:00

### ***Managing Your Investment Managers***

John Harrison, Independent Advisor

For many LGPS pension funds, the task of investing the majority of the fund's assets is delegated to external investment managers. But how can Pensions Committees effectively and efficiently control the hiring, monitoring and replacement process of these managers? In this first session John, an independent advisor to an LGPS Fund, gives his views on the manager oversight process, and shares some hints and tips for Pensions Committee members.



10:00 - 10:35

### ***Diversification – Is It Really A Free Lunch?***

Atul Shinh, Investment Specialist, Multi-Asset team, Investec Asset Management



The concept of "Diversification", or in other words, not putting all your eggs in one basket, is designed to reduce your risk by spreading (diversifying) your investments. While the principle of spreading your risk across different investments is sound, certain investors' experiences of diversification have been less than satisfactory, with "diversified" portfolios failing to provide the outcomes that would have been expected in such cases.



In this session, Atul will explain the basics behind the concept of diversification (including its benefits), highlighting some of the fallacies of diversification, and will also describe some of the methods and techniques that can be used to improve investor outcomes from diversification.

10:35 - 11:10

### ***Liability Hedging – What Affects The Value Of A Scheme's Liabilities?***

Alex Soulsby, Head of Liability Driven Investment, F&C Investments



Historically, many Pensions Committees spent a great deal of time focussing solely on the investment arrangements of their respective Funds. However, it is now widely accepted that investment strategy should be considered with the Fund's liabilities clearly in mind. But what do we mean when we talk about liabilities? And what kind of factors affect the value that is placed on them?



In this session Alex will look at how specific market risks can change the value of a pension scheme's liabilities, answer how Liability Driven Investment (or LDI for short) strategies can be used to manage these risks and why without hedging, pension schemes may not be able to meet their future liabilities.

11:10 - 11:35

### ***Coffee Break***



11:35 - 12:10

***Effectiveness and Accountability in Politics***

The Rt. Hon Margaret Hodge, MP

Margaret Hodge MBE was elected Member of Parliament for Barking in 1994. She is also the Chair of the Public Accounts Committee, and held a number of senior roles in the Labour Government between 1998 and 2010. In the 2010 General Election Margaret fought off the challenge from Nick Griffin and the British National Party in her constituency, doubling her majority to 16,555. Also in 2010, Margaret became the first ever female Chair of the Public Accounts Committee.



12:10 - 12:45

***Private Equity: Keep Calm and Mind the Gap***

Carolyn Skuce, Director, Business Development, and Mark Drugan, Managing Director, Head of Investment Management Europe, Capital Dynamics



Private Equity returns have consistently outperformed the quoted markets in the long term and provide a valuable solution to bridging LGPS funding gaps, but what is private equity? Why should pension funds invest in private equity? What drives returns? How can barriers to access be mitigated? In light of the recent DCLG Consultation on the future of the LGPS, what place does private equity hold in future investment strategies for Funds? In this session, Carolyn and Mark will talk about the basics of private equity, performance and future opportunities.



12:45 - 13:45

***Lunch***

13:45 - 14:20

***5 Things That Will Make the 2015 Election Unique***

James Morris, Director, European Office, Greenberg Quinlan Rosner Research

James is a campaign pollster and strategist. A former speech writer to Labour leader Ed Miliband and advisor at the Number 10 Strategy Unit, Morris runs Greenberg Quinlan Rosner's London office. Since joining the firm in 2010, James has advised corporate, NGO and political clients around the world. He ran strategy for Ed Miliband's against-the-odds victory in the Labour party leadership campaign and continues to advise the Labour leader.



14:20 - 14:55

***Session topic to be confirmed shortly***

14:55 - 15:20

***Coffee***



15:20 - 15:55

***Adventures In Security Selection: Who Should We Lend Your Money To?***

Blair Reid, Portfolio Manager, BlueBay Asset Management LLP

Buying bonds is essentially lending money to a business, as opposed to equities which is buying a stake in the business. Many presentations are made to LGPS Pension Committees about the performance of fixed interest portfolios. But what lies underneath? How are fixed interest portfolios put together? And who decides what goes in to them? In this session Blair looks at the factors BlueBay considers most important when deciding which companies or governments to whom they should lend client money.



15:55 - 16:40

***Politics - Stranger Than Fiction?***

Lord Dobbs of Wyllye

Michael Dobbs was with Margaret Thatcher when she first entered Downing Street as Prime Minister, and was with John Major when he was kicked out. In between times, he wrote House of Cards, perhaps the most celebrated political novel of recent decades, which was made into award winning BBC and US TV series. The third season of the US version is currently being filmed, with Kevin Spacey in the leading role.



Michael was Chief of Staff and later Deputy Chairman of the Conservative Party. In his restless search for a proper job, he's also been Deputy Chairman of Saatchi & Saatchi, he presented the BBC TV current affairs programme Despatch Box and was a columnist for The Mail on Sunday.

He has also penned the hugely acclaimed theatre play, 'The Turning Point', yet it is as an author that he has gained most plaudits. After creating the iconic figure of 'Francis Urquhart' he has gone on to write books about Prime Ministers, Kings and the Dalai Lama. He also wrote a series of novels about Winston Churchill that had the critics falling over themselves in praise.

Michael has many years of experience in the United States, with a doctorate from Harvard and Tufts universities. He also worked on the Boston Globe throughout the Watergate scandal. House of Cards is one of PBS's all-time most requested TV series and his Churchill novels have been best-sellers across the States.

He has helped raise tens of thousands of pounds for charities in recent years. Yes, there is a softer side to him, yet his past follows him. One newspaper described Dobbs as "Westminster's baby-faced hit man." Another said he was "a man who, in Latin America, would have been shot." A third wrote that "he was clearly put on this earth to write thrillers of the most shameless page-turning quality."

16:40 - 16:45

**Close**

David Crum, Owner, 330 Consulting



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### How to Register:

If you would like to register to attend this event, please either:

- Send an email to 'david@330consulting.com' with your contact details
  - Register to attend via the 'events' section of my website at [www.330consulting.com](http://www.330consulting.com)
-

## **Pension Fund Committee**

Meeting to be held on 28<sup>th</sup> November 2014

Electoral Division affected: <u>None</u>
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### **External Audit –**

### **Lancashire County Pension Fund Audit Findings Report 2013/14**

(Appendix A refers)

Contact for further information:

Karen Murray, Director, Grant Thornton 0161 234 6364

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### **Executive Summary**

The Audit Findings Report at Appendix 'A', sets out the findings of the external auditor following their audit of the Pension fund Accounts for 2013/14. This report was presented to the Council's Audit Committee on 29 September 2014. The external auditor provided an unqualified audit opinion on the pension fund accounts following the meeting on 29 September 2013.

### **Recommendation**

The Committee is asked to note the External Audit report following their audit of the County Pension Fund Accounts for 2013/14.

### **Background and Advice**

Attached at Appendix 'A' is the external auditor's Audit findings Report following their audit of the accounts for Lancashire County Pension Fund for 2012/13. This includes reporting the outcome of their work against the main audit risks highlighted to the Pension Committee at its March 2014 meeting, which included the triennial valuation process and the introduction of the new LGPS 2014.

Representatives of Grant Thornton will be in attendance to present the report and address any questions from members.

### **Consultations**

The report has been agreed with the County Treasurer.

### **Implications:**

This item has the following implications, as indicated:

## **Risk management**

No significant additional risks have been identified.

## **Local Government (Access to Information) Act 1985 List of Background Papers**

Paper	Date	Contact/Directorate/Tel
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N/a		
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Reason for inclusion in Part II, if appropriate

N/a
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# The Audit Findings Report for Lancashire County Pension Fund

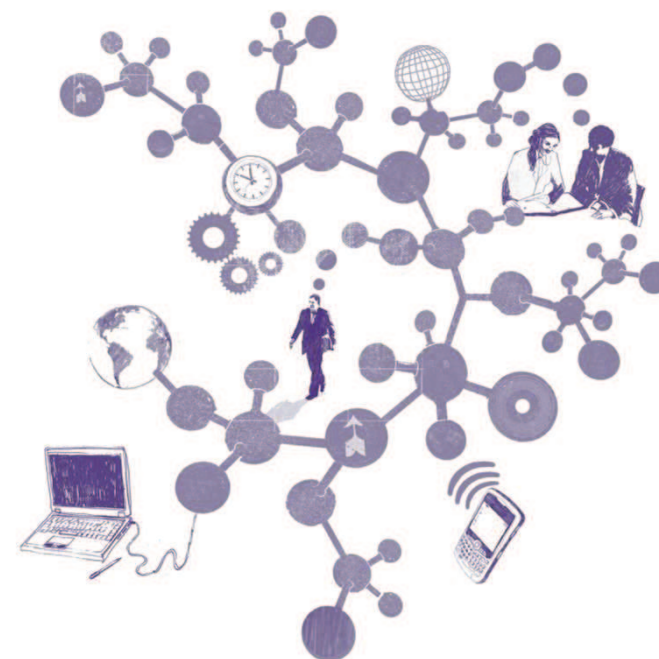
Year ended 31 March 2014

September 2014

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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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# Contents

Section	Page
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2. Audit findings	6
3. Fees, non audit services and independence	15
4. Developments relevant to your pension fund and the audit	17
5. Communication of audit matters	19

## Appendices

- A Audit opinion with Lancashire County Council statements
- B Audit Opinion for the Pension Fund Annual Report

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## Section 1: Executive summary

**01. Executive summary**

**02. Audit findings**

**03. Fees, non audit services and independence**

**04. Future developments**

**05. Communication of audit matters**



# Executive summary

## Purpose of this report

This report highlights the key issues arising from the audit of Lancashire Pension Fund's ('the Fund') financial statements for the year ended 31 March 2014. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of International Standard on Auditing (UK & Ireland) 260.

Under the Audit Commission's Code of Audit Practice we are required to report whether, in our opinion, the Fund's financial statements present a true and fair view of the financial position, the financial transactions of the Fund during the year and whether they have been properly prepared in accordance with the Code of Practice on Local Authority Accounting.

## Introduction

In the conduct of our audit we have not had to alter or change our planned audit approach, which we communicated to you in our Audit Plan dated 31 March 2014.

Our audit is substantially complete although we are finalising our procedures in the following areas:

- obtaining and reviewing the management letter of representation;
- updating our post net asset statement events review up to the date of signing the audit opinion;
- our review of the Annual report; and
- our final review procedures, including agreement of amended accounts.

We received draft financial statements and accompanying working papers at the start of our audit, in accordance with the agreed timetable.

## Key issues arising from our audit

### Financial statements opinion

We anticipate providing an unmodified opinion on the Fund's financial statements.

We have not identified any adjustments affecting the Fund's reported financial position, which recorded net assets carried forward of £5.2bn. We have agreed a number of adjustments to improve the presentation of the financial statements.

The key messages arising from our audit of the Fund's financial statements are:

- the draft financial statements were provided at the start of our audit work and high quality working papers were made available;
- one adjustment was required to the wording on a restatement to investments and liabilities 2012/13 balances on the Net Asset Statement to make it clear it is not a prior period adjustment but has been updated for comparability only;
- some disclosure and compliance improvements were needed, but no fundamental or other material adjustments were required;
- officers were available throughout our audit fieldwork to provide additional supporting information in a timely manner and resolved our queries promptly.

Further details are set out in section 2 of this report.

## Acknowledgement

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

**Grant Thornton UK LLP**  
**September 2014**

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## Section 2:    Audit findings

01. Executive summary

02. Audit findings

03. Fees, non audit services and independence

04. Future developments

05. Communication of audit matters

## Audit findings

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and additional matters that arose during the course of our work. We set out on the following pages the work we have performed and findings arising from our work in respect of the audit risks we identified in our audit plan, presented to the Audit and Governance Committee on 31 March 2014. We also set out the adjustments to the financial statements from our audit work and our findings in respect of internal controls.

### **Changes to Audit Plan**

We have not made any changes to our Audit Plan as previously communicated to you on 31 March 2014.

### **Audit opinion**

We anticipate that we will provide the Fund with an unmodified opinion. Our audit opinions are set out in Appendix A and B.

We are required to report all misstatements to those charged with governance, whether or not the financial statements have been adjusted by management. There no material adjusted or unadjusted misstatements to report.

## Audit findings against significant risks

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty" (ISA 315). In this section we detail our response to the significant risks of material misstatement which we identified in the Audit Plan. As we noted in our plan, there are two presumed significant risks which are applicable to all audits under auditing standards.

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
1.	<b>Improper revenue recognition</b> Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition	We have rebutted this presumption and therefore do not consider this to be a significant risk for Lancashire County Pension Fund. This is because: <ul style="list-style-type: none"> <li>• The nature of the Pension Fund's revenue is, in many respects, relatively predictable and does not generally involve cash transactions.</li> <li>• The split of responsibilities between the Pension Fund, its Fund Managers and the Custodian, provides a clear separation of duties reducing the risk around investment income.</li> <li>• Revenue contributions are made by direct salary deductions and direct bank transfers from admitted /scheduled bodies, are supported by separately sent schedules and are directly attributable to gross pay making any improper recognition unlikely.</li> <li>• Transfers into the scheme are all supported by an independent actuarial valuation of the amount which should be transferred and which is subject to agreement between the transferring and receiving funds.</li> </ul> Other related revenue recognition audit work, included <ul style="list-style-type: none"> <li>• review and testing of revenue recognition policies</li> <li>• testing of material revenue streams</li> <li>• review of unusual, significant transactions.</li> </ul>	Our rebuttal presumption and other audit related work has not identified any issues in respect of revenue recognition.
2.	<b>Management override of controls</b> Under ISA 240 there is a presumed risk of management over-ride of controls	We have undertaken: <ul style="list-style-type: none"> <li>• a review of accounting estimates, judgements and decisions made by management</li> <li>• testing of journals entries</li> <li>• a review of unusual significant transactions.</li> </ul>	Our audit work has not identified any evidence of management override of controls. In particular, our review of journal controls and testing of journal entries have not identified any significant issues.  We set out later in this section of the report our work and findings on key accounting estimates and judgements.

## Audit findings against other risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
<b>Investments</b>	<ul style="list-style-type: none"> <li>Investments not valid</li> <li>Alternative investments not valid</li> <li>Investment activity not valid</li> <li>Fair value measurements not correct</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>reviewed independent verification of year end holdings and in-year purchases and sales from the fund managers and the custodian.</li> <li>a reconciliation between information provided by the fund managers, the custodian and the Pension Fund's own records and sought explanations for any variances.</li> <li>tested the valuation of a sample of the individual investments held by the Fund at the year end. For any unquoted investments we critically assessed the assumptions and basis of underlying estimations of investment values.</li> <li>completed procedures to enable us to rely on pension fund's property valuers in respect of property investments and we have tested for completeness and validity.</li> <li>confirmed the existence of investments directly with the independent custodian and property valuer or by agreement to relevant documentation.</li> </ul>	<p>Our audit work has not identified any investments held by the Fund that are not valid, or where the fair value measurement is not correct.</p> <p>Our audit work supports the valuations of investments where estimation techniques and judgement have been applied.</p>
<b>Benefit Payments</b>	<ul style="list-style-type: none"> <li>Benefits improperly computed/ liability understated</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>performed tests of controls over new pensions in payment and associated lump sum benefits.</li> <li>rationalised pensions paid with reference to changes in pensioner numbers and increases applied in the year together with comparing pensions paid on a monthly basis to ensure that any unusual trends have been satisfactorily explained.</li> <li>compared the movements on membership statistics to material transactions in the accounting records.</li> </ul>	<p>Our audit work has not identified any significant issues in relation to the risk identified.</p>

## Audit findings against other risks - continued

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan. Recommendations, together with management responses are attached at Appendix A.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
<b>Contributions</b>	<ul style="list-style-type: none"> <li>Recorded contributions not correct</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>performed a test of controls on the Administering Authority's contributions monitoring procedures.</li> <li>rationalised contributions received with reference to changes in member body payrolls and numbers of contributing pensioners to ensure that any unexpected trends have been satisfactorily explained.</li> </ul>	Our audit work has not identified any significant issues in relation to the risk identified.
<b>Member data</b>	<ul style="list-style-type: none"> <li>Member data not correct</li> <li>Regulatory/scheme rules requirements not met</li> <li>Actuarial amounts not determined properly</li> </ul>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>confirmed the system of controls and reconciliations covering the determination of member eligibility, the input of evidence into the Pensions Administration System and the maintenance of member records.</li> <li>substantively tested changes to Member Data.</li> <li>examined the reconciliation of membership numbers for each category of member to previous year's figures via retirements, leavers and starters.</li> </ul>	Our audit work has not identified any significant issues in relation to the risk identified.

# Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Fund's financial statements.

Accounting area	Summary of policy	Comments	Assessment
<b>Revenue recognition</b>	<ul style="list-style-type: none"> <li>Contribution Income: normal contributions for both employee and employers is accounted for on an accruals basis.</li> <li>Transfers to and from the scheme: Transfers are recognised when they are received / paid.</li> <li>Investment Income: The Fund adopts several different recognition approaches dependent on the types of investment as disclosed within the statements.</li> </ul>	<ul style="list-style-type: none"> <li>The revenue recognition policies of the Fund are appropriate and in line with the relevant accounting framework.</li> <li>The application of the revenue recognition policies at the Fund is not considered complex, and our testing has not identified any inappropriate revenue recognition.</li> </ul>	<b>Green</b>
<b>Judgements and estimates</b>	<ul style="list-style-type: none"> <li>Key estimates and judgements include : <ul style="list-style-type: none"> <li>investment valuation for unquoted, hard to value investments</li> <li>pension fund actuarial valuations and settlements.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>The valuation of the Fund's hard-to-value investments have been substantively tested to gain assurance that it is not materially misstated</li> <li>We have confirmed that the work of the actuary is in line with professional standards and regulation, and that they are a reliable source of estimation relating to the pension fund liabilities.</li> </ul>	<b>Green</b>
<b>Other accounting policies</b>	<ul style="list-style-type: none"> <li>We have reviewed the Fund's policies against the requirements of the CIPFA Code and accounting standards.</li> </ul>	<ul style="list-style-type: none"> <li>Our review of accounting policies has not highlighted any significant issues which we wish to bring to your attention, however, some minor presentational improvements have been agreed.</li> </ul>	<b>Green</b>

## Assessment

● Marginal accounting policy which could potentially attract attention from regulators

● Accounting policy appropriate but scope for improved disclosure

● Accounting policy appropriate and disclosures sufficient

## Misclassifications & disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Adjustment type	Account balance	Impact on the financial statements
1 Disclosure	Leases (Operating Leases)	The rental arrangements relating to the investment properties of the Fund have been assessed as operating leases. Appropriate additional disclosures including minimum lease payments have been made.
2 Disclosure	Other disclosure notes including: <ul style="list-style-type: none"> <li>• Accounting policies</li> <li>• Note 4 Critical judgements and estimates</li> <li>• Note 15 Reconciliation of movements in investments and derivatives</li> <li>• Note 16 Financial Instruments classification</li> <li>• Note 19 Nature and extent of risks arising from financial instruments</li> <li>• Footnote to Net Assets Statement</li> </ul>	<p>A number of other changes have been agreed to the financial instrument disclosure notes to ensure that they meet the Code and accounting standards requirements, and to other disclosures to improve clarity.</p> <p>The key changes amended by management have been:</p> <ul style="list-style-type: none"> <li>• Accounting policies required additional narrative on investment income and financial liabilities disclosures.</li> <li>• Critical judgements and estimates disclosure updated to clarify which are the most significant judgements and to highlight which judgements are the most important.</li> <li>• Reconciliation of movements in investments and derivatives expanded to clarify the reconciliation between summary of portfolio values to investment categories.</li> <li>• Financial Instruments classification expanded to reflect these are not all designated at fair value through the profit and loss because there are assets and liabilities in other IFRS7.8 categories.</li> <li>• Nature and extent of risks arising from financial instruments edited so that fixed interest securities removed from the interest rate risk section and the price risk disclosures investment accruals was incorrectly classified as a cash equivalent.</li> <li>• Comparators on the face of the Net Assets Statement have been restated, but do not meet the requirements for a prior period adjustment (under IAS1). The amendment is to allow comparability, in line with Code of Practice on Local Authority Accounting (3.4.20).</li> </ul>



## Internal controls

The purpose of an audit is to express an opinion on the financial statements.

Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards. We have not identified any issues of significance to bring to your attention.

As part of our planned programme of work, our information systems specialist team undertook a high level review of the general IT control environment at the Administering Authority. This was undertaken as part of the review of the internal controls system. We are pleased to report that no significant issue arose from our work. We identified a small number of areas where the Council's existing IT arrangements can be further developed. None of these are specific to the Pension Fund and have been shared with the Chief Financial Officer for information.

From the work we have completed we have not identified any significant weaknesses in internal controls.

## Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards to communicate to those charged with governance.

	Issue	Commentary
1.	<b>Matters in relation to fraud</b>	<ul style="list-style-type: none"> <li>We have previously discussed the risk of fraud with the Audit and Governance Committee and were not informed of any significant matters in relation to fraud. We have not been made aware of any incidents in the period and no other issues have been identified during the course of our audit procedures.</li> </ul>
2.	<b>Matters in relation to laws and regulations</b>	<ul style="list-style-type: none"> <li>We are not aware of any significant incidences of non-compliance with relevant laws and regulations.</li> </ul>
3.	<b>Written representations</b>	<ul style="list-style-type: none"> <li>A standard letter of representation has been requested from the Fund.</li> </ul>
4.	<b>Disclosures</b>	<ul style="list-style-type: none"> <li>Our review found no material omissions in the financial statements with exception of those listed on page 12.</li> </ul>
5.	<b>Matters in relation to related parties</b>	<ul style="list-style-type: none"> <li>We are not aware of any related party transactions which have not been disclosed with the exception of key management personnel disclosures. However, this is due to a difference in interpretation of the CIPFA Code in this respect:</li> <li>IAS 24 requires the inclusion of an extended disclosure note about the compensation of key management personnel. The CIPFA code includes a specific dispensation from this requirement, instead following the regulatory disclosure requirements around remuneration of members and staff. The Fund has chosen to follow the CIPFA example pension fund accounts which refer to this dispensation in the Pension Fund disclosure notes, (note 24), and cross references the reader to the Council's main financial statements where such regulatory disclosures are made.</li> <li>In our view, such a disclosure is not appropriate since the regulatory disclosures in the Council's main accounts include senior management personnel who are not involved in the management of the pension fund and will exclude some who are. Additionally, in the context of the separately published Pension Fund Annual Report., such cross referencing is not helpful. In our view the Fund should either make the full IAS24 disclosures within the pension fund accounts, or make the regulatory disclosures set out in the Code specific to those key management personnel involved in the Pension Fund. However we recognise that the position taken by the Fund is not inconsistent with the Code or CIPFA's guidance (in the form of the example pension fund accounts provided by them).</li> </ul>
6.	<b>Going concern</b>	<ul style="list-style-type: none"> <li>Our work has not identified any reason to challenge the Fund's decision to prepare the financial statements on a going concern basis.</li> </ul>

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## Section 3: Fees, non audit services and independence

01. Executive summary

02. Audit findings

03. Fees, non audit services and independence

04. Future developments

05. Communication of audit matters

# Fees, non audit services and independence

We confirm below our final fees charged for the audit and providing assurance to other auditors agreed under the IAS19 protocol

## Fees

	Per Audit plan £	Actual fees £
Fund audit	34,169	34,169
IAS19 Protocol audit work	1,737	1,737
<b>Total audit fees</b>	<b>35,906</b>	<b>35,906</b>

**There is no change in the audit fee as reported in the Audit Plan. The audit fee of £1,737 relates to providing assurance to other auditors under the IAS19 protocol, which has been approved by the Audit Commission and discussed with officers.**

## Fees for other services

Service	Fees £
None	Nil

## Independence and ethics

Ethical standards and International Standards on Auditing (ISA) 260 require us to give you full and fair disclosure of matters relating to our independence. In this context, we disclose the following to you:

- the in-charge member of our team has a family member who works within the Pension Fund's benefits administration team. To avoid any potential conflicts, this member of our team does not undertake any work on the benefits payable elements of the accounts and is not responsible for the planning or supervision of such work.

We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

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## Section 4: Future developments

01. Executive summary

02. Audit findings

03. Fees, non audit services and independence

04. Future development

05. Communication of audit matters

# Developments relevant to your Pension Fund and the audit

Political	Environmental	Social	Technological
Developments relevant to the next financial year			
<b>1. Financial reporting</b>  CIPFA has published best practice guidance relating to the identification and disclosure of administrative and investment management expenditure. This applies from 2014/15 and will enable consistent reporting across the LGPS facilitating more meaningful comparisons in this area. The definition is separated into three distinct categories of costs.	<b>2. Legislation</b>  Under the Local Government Pension Scheme (LGPS 2014), pensions will be calculated on Career Average Revalued Earnings (CARE) rather than a final salary basis from 1 April 2014. Administering authorities will need to ensure their updated administration systems are calculating new pensions accruals correctly from 1 April 2014; dealing effectively with more complex data requirements and that new contribution rates are being correctly applied by employers.	<b>3. Actuarial valuation</b>  Following the 31 March 2013 actuarial valuation all employers will need to consider the level of additional employer deficit contributions required and how to fund them.	<b>4. Other issues</b>  The number of LGPS employers continues to grow as local authorities outsource services. Affected funds need to consider the impact this has on its exposure to risks and reflect on the impact this has for their investment strategies.
Developments relevant to future periods			
<b>1. Financial reporting</b>  Changes to the Pension SORP may affect the investment disclosures in the Net Asset Statement and Fair Value determination (changing the classification from level 1, 2 & 3 to A, B & C). A revised SORP will be issued in 2014 and may find its way into the LG code in 2015/16.	<b>2. Legislation</b>  From April 1 2015 The Pensions Regulator will have formal powers and responsibilities for oversight of the LGPS. This will include monitoring implementation of new governance arrangements, which require the creation of a scheme manager and pension board for each LGPS.  The Administering Authority will need to determine how it will meet the requirement to have a pension board and the consequent changes it will need to make to its general governance arrangements.	<b>3. Structural reform</b>  DCLG is consulting on the potential use of Collective Investment Vehicles and passive management of funds.  The outcome of this consultation may lead to a change in administration of some schemes and significant changes in investment strategies.	<b>4. Other issues</b>  The Pensions Regulator, Financial Conduct Authority and HMRC continue to commit resources to combat pension liberation schemes. More guidance and potential changes to HMRC registration of new schemes is likely.

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## Section 5: Communication of audit matters

01. Executive summary

02. Audit findings

03. Fees, non audit services and independence

04. Future developments

05. Communication of audit matters

# Communication of audit matters to those charged with governance

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

The Audit Plan outlined our audit strategy and plan to deliver the audit, while this Audit Findings report presents the key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

## Respective responsibilities

The Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission ([www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)).

We have been appointed as the Fund's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Fund's key risks when reaching our conclusions under the Code.

It is the responsibility of the Fund to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Fund is fulfilling these responsibilities.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Compliance with laws and regulations		✓
Expected auditor's report		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓



# Appendices

# Appendix A: Audit opinion for Lancashire County Council as Administering Authority

**We anticipate that we will provide the Fund with an unmodified audit report within the Lancashire County Council financial statements**

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LANCASHIRE COUNTY COUNCIL

### Opinion on the pension fund financial statements

We have audited the pension fund financial statements of Lancashire County Council for the year ended 31 March 2014 under the Audit Commission Act 1998. The pension fund financial statements comprise the Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

This report is made solely to the members of Lancashire County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's Members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of the Treasurer and auditor

As explained more fully in the Statement of responsibilities for statement of accounts, the Treasurer is responsible for the preparation of the Authority's Statement of Accounts, which includes the pension fund financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the pension fund financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Treasurer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Introduction

to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on the pension fund financial statements

In our opinion the pension fund's financial statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2014 and the amount and disposition of the fund's assets and liabilities as at 31 March 2014; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and applicable law.

### Opinion on other matters

In our opinion, the information given in the Introduction for the financial year for which the financial statements are prepared is consistent with the financial statements.

Karen Murray  
Director for and on behalf of Grant Thornton UK LLP, Appointed Auditor

Grant Thornton UK LLP  
4 Hardman Square  
Spinningfields  
Manchester M3 3EB

30<sup>th</sup> September 2014

## Appendix B: Audit opinion for the Annual Report

**We anticipate that we will provide the Fund with an unmodified audit report within the Pension Fund Annual Report**

### **INDEPENDENT AUDITOR'S STATEMENT TO THE MEMBERS OF LANCASHIRE COUNTY COUNCIL ON THE PENSION FUND FINANCIAL STATEMENTS**

We have examined the pension fund financial statements for the year ended 31 March 2014, which comprise the Fund Account, the Net Assets Statement and the related notes.

This report is made solely to the members of Lancashire County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's Members as a body, for our audit work, for this report, or for the opinions we have formed.

#### **Respective responsibilities of the Treasurer and the auditor**

As explained more fully in the Statement of responsibilities for the statement of accounts, the Treasurer is responsible for the preparation of the pension fund's financial statements in accordance with applicable United Kingdom law.

Our responsibility is to report to you our opinion on the consistency of the pension fund financial statements within the pension fund annual report with the pension fund financial statements in the statement of accounts of Lancashire County Council, and its compliance with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

We also read the other information contained in the pension fund annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the pension fund financial statements. The other information consists of only Foreword, Administration of Fund, Investment Policy and Performance and Actuarial Valuation.

We conducted our work in accordance with guidance issued by the Audit Commission. Our report on the administering authority's full annual statement of accounts describes the basis of our opinion on those financial statements.

### **Opinion**

In our opinion, the pension fund financial statements are consistent with the full annual statement of accounts of Lancashire County Council for the year ended 31 March 2014 and comply with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

Karen Murray  
Director for and on behalf of Grant Thornton UK LLP, Appointed Auditor

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30 September 2014



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