

Pensions Committee

2.00 p.m., Monday, 20 March 2017

Governance Update

| | |
|-------------------|-----|
| Item number | 5.5 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

The purpose of this report is to update the Committee on the rotation of the Pension Board chair, training activities over 2016/17 and various other governance matters.

Links

| | |
|--------------------------|----------------------|
| Coalition pledges | |
| Council outcomes | CO26 |
| Single Outcome Agreement | |

Governance Update

Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Pensions Committee should consider;
- 1.2 Note the verbal update from the Pension Board regarding the newly appointed chair of the Pension Board effective from 1 April 2017 to 31 March 2018;
- 1.3 Thank Jim Anderson's for his significant contribution during his tenure as the Chair of the Pension Board;
- 1.4 Note the nominations for the non-elected members of the Committee;
- 1.5 Note the update regarding the Pension Board Insurance liability;
- 1.6 Note the update on the recent petition;
- 1.7 Note the recent release of the report on the Scottish Government's governance review and that a report on its recommendations and impact on the Fund will be considered by the Committee later in 2017; and
- 1.8 Note the Accounts Commission's Local Government Pensions supplement overview prepared by Audit Scotland.

Background

- 2.1 The Fund reports annually to Committee on governance matters including its compliance with the Appointments and Nominations Policy and its Training and Attendance Policy, and any other related matters that arise.

Main report

Rotation of the Pension Board Chair & Membership of the Pension Board

- 3.1 The Fund's constitution states that '*the chairman of the Pension Board will be rotated on an annual basis*'. In the Pension Board's second year the chair was drawn from the union membership of the Pension Board. The 2017/18 chair is required to be drawn from the employer membership of the Pension Board.
- 3.2 The Pension Board are meeting in advance of the Pensions Committee and are expected to provide a verbal update to the Committee regarding who they have appointed as chair.

- 3.3 Over the last year the Pension Board have received four resignations, Rucelle Soutar, Linda McDonald, Simon Belfer (all employer representatives) and Graeme Turnbull (member representative). Sharon Dalli, Paul Ritchie and Alan Williamson (all employer representatives) have joined the Board. At the time of writing, the Fund is in the process of appointing a new member representative and a verbal update will be reported to Committee.

Non-Elected Members of the Pensions Committee

- 3.4 Non-elected members of the Pension Committee can serve a maximum of two consecutive years before either standing down or submitting themselves as a candidate for further election. The current non-elected Pension Committee members were appointed in February 2015 therefore the Fund advertised the seats in February 2017 via the Fund's website and employer bulletin.
- 3.5 The Fund subsequently received two applications for the posts, one application for the employer representative and one application for the member representative, from Richard Lamont and John Anzani respectively. They are the current incumbents for the respective roles. In accordance with the Lothian Pension Fund's Appointment and Nomination policy, the applications have been agreed by the review panel and formal approval of the appointments will be sought from Council in May 2017.

Training hours 2017/18 for the Pensions Committee and Pension Board

- 3.6 The Fund's training policy sets out that a minimum of three days (21 hours) training hours are expected of Pensions Committee and Pension Board members. The Pensions Regulator also requires those involved with the governance of local government pension schemes to develop and build sufficient knowledge to effectively carry out their role.
- 3.7 Appendix 1 of this paper provides a breakdown of training of the Pension Committee and Board.
- 3.8 Although one Pensions Committee member and five Pension Board members, as at 8 February 2017, do not meet the required training hours there are two further training opportunities in March and it is expected that all Committee and Board members will fully achieve the minimum training requirement by the end of March.
- 3.9 The Fund aims to continue to provide quarterly reminders of training hours and details of future training opportunities to ensure the Pensions Committee and Pension Board members continue to achieve the training requirements.

Pension Board insurance liability

- 3.10 Over the last two quarters the Fund has reported on Pension Board liability insurance. The Fund initially sought advice from the City of Edinburgh Councils insurance team who confirmed that the Pension Board would not be covered under the Councils existing liability provision. The Fund then approached three insurance providers, AON, Zurich and the Occupational Pensions Defence Union (OPDU). AON provided an initial quote which was high and may not have

provided the necessary insurance required, OPDU were not able to provide insurance for Pension Boards at this time and Zurich were still researching the issue.

- 3.11 As set out in the Service Plan update in December 2016, the Fund identified two insurance groups that are considering insurance liability for Pension Board Members, AON and Zurich. As reported to the Committee in December, the view from Zurich's insurer is that although the legal relationships are now understood the risk exposure seems very limited. Since the last report in December they have developed a solution for indemnifying Local Pension Board Members under their Official's Indemnity policy which is an addition to the existing policy for Councils It is not available as a stand-alone policy. AON also concede that the risk is viewed as remote however Pension Boards are new therefore their underwriters have taken a cautious approach. The City of Edinburgh Council's Insurance Manager has confirmed that, to date, AON have not made an addition to include the Pension Board on the existing policy for City of Edinburgh Council. A further update will be provided to Committee when the Fund hears any more information regarding this matter.

Petition from Campaign Against Arms Trade and Edinburgh Peace and Justice Centre

- 3.12 A petition was raised by the Campaign Against Arms Trade and Edinburgh Peace and Justice Centre in February 2017 calling on 'the City of Edinburgh Council to do everything within its powers and remit to require that Lothian Pensions Trust divest from all investments concerning arms manufacture'. The petition was raised on 7 February 2017 and will close on 23 March 2017.
- 3.13 Before a petition can be considered by the Petitions Committee it must receive at least 200 signatures from people living in the City of Edinburgh Council Area, or from 20 businesses that are on the Valuation Roll. The Convener of the Petitions Committee has the power to declare a petition signed by more than 50 people valid, if it relates to a local issue or a community of interest. At the time of writing this paper the petition had 385 signatories. The Petitions Committee is due to meet on 30th March. The Fund will ensure the Pensions Committee and Pension Board are kept informed of the outcome.

Scottish Public Service Pensions Agency Governance Review

- 3.14 In September 2016 the Scottish Public Pension Agency commissioned KPMG to undertake a Pensions Governance Review to assess the new governance arrangements introduced in April 2015 for public sector pension schemes, including the Scheme Advisory Board and Pension Boards. The Fund has been involved in the review process, providing comments on the initial remit and taking part in the review itself. In particular, two members of the Pension Board, the Convenor of the Pensions Committee and the Chief Executive of the Fund have been interviewed. A questionnaire was also circulated to members of the Pension Board.

- 3.15 The report on the review was received on 28 February and it has been circulated via email to members of the Pensions Committee and the Pension Board. Comments on the report were sought by the Scottish Government by 20 March. It is anticipated that the report will be considered by Scottish Government ministers in the coming months. A report on the outcome of the review and the potential implications for Lothian Pension Fund will be submitted to the Pensions Committee later in 2017.

Accounts Commission Overview of the LGPS

- 3.16 The Accounts Commission, the public spending watchdog for the Local Government, publish a financial overview of accounts and audit each financial year. The financial overview for 15/16 from the Accounts Commission is now available and a link to the report is available later in this report. This year, the Accounts Commission have also provided a supplementary report on the Local Government Pension Scheme which is set out in Appendix 2 of this report. It sets out various comparisons of the Pension Funds in Scotland.

Measures of success

- 4.1 The Fund is governed effectively with each Pensions Committee and Pension Board member having a clear knowledge of their responsibilities and a fully functioning Committee and Board.
- 4.2 The Pensions Committee and the Pension Board function in accordance with their respective remits and mandates/constitutions.
- 4.3 The Pensions Committee and Pension Board members meet the required training and knowledge standards set out by the Pension Regulator.

Financial impact

- 5.1 None.

Risk, policy, compliance and governance impact

- 6.1 The Pensions Committee must undertake training in line with the Training and Attendance policy. Training and attendance must be monitored and reviewed.
- 6.2 The Pension Board has the knowledge and understanding to enable its members to properly exercise their functions. All training and attendance is monitored and is compliant with the Pension Regulator Code.
- 6.3 Two external Pensions Committee members, one employer representative and one member representative with full voting rights are elected to the Committee in accordance with the terms of reference and elected as set out in the nomination and appointments policy.

Equalities impact

7.1 None

Sustainability impact

8.1 None

Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

[Local Government in Scotland Financial Overview 2015/16, Accounts Commission, prepared by Audit Scotland, November 2016.](#)

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Links

Coalition pledges

Council outcomes CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

Single Outcome Agreement

Appendices

Appendix 1 – Committee and Pension Board Members' Training Record from 1 April 2016 to 31 March 2017

Appendix 2 – Local Government Pension Scheme Supplement 2015/16, Accounts Commission, prepared by Audit Scotland.

| Event: | TPR online training | PLSA Investment Conference | Internal Training Investments | Sarah Smart Session | Audit Sub Committee Preparation | Pension Committee Preparation | Internal Training Session | LGC Investment Seminar | Sarah Smart Session | Audit Sub Committee Preparation | Pension Committee Preparation | LGPS investment training seminar | PLSA Annual Conference | Internal training session | Sarah Smart Session | Audit Sub Committee Preparation | Pension Committee Preparation | LAPFF Conference (Bournemouth) | LGPS (Scotland) Seminar | Internal Training Session | Pensions & Lifetime Savings Conference. | Sarah Smart Session | Pension Committee Preparation | Additional training/reading | Total | |
|--|---------------------|----------------------------|-------------------------------|---------------------|---------------------------------|-------------------------------|---------------------------|------------------------|---------------------|---------------------------------|-------------------------------|----------------------------------|------------------------|---------------------------|---------------------|---------------------------------|-------------------------------|--------------------------------|-------------------------|---------------------------|---|---------------------|-------------------------------|-----------------------------|-------------------|-------|
| Date | | 16-18/05/15 | 7/6/16 | 27/6/16 | 22/6/16 | 27/6/16 | 7/9/16 | 8-9/9/16 | 28/9/16 | 27/9/16 | 28/9/16 | 5-6/10/16 | 19-21/10/16 | 15/11/16 | 6/12/16 | 5/12/16 | 6/12/16 | 7-9/12/16 | 12/12/16 | 1/3/17 | 8-10/03/17 | 20/3/17 | 20/3/17 | | | |
| Pensions Committee | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Maureen Child | | | 3 | 0 | 1 | 2.5 | | 0 | 0 | 1.5 | 3 | | 0 | 0 | 1 | 0 | 0 | | | | | | | | 12 | |
| Bill Cook | | 11 | 3 | 0 | 0.5 | 1 | 2 | | 0 | 0.5 | 1.5 | 5 | | 3 | 0 | 0 | 0 | 0 | | | | | | | 27.5 | |
| Jim Orr | | | 3 | 1.75 | 0.5 | 1 | 3 | | 0 | 0.5 | 1.5 | 8 | | 3 | 0.58 | 0.5 | 1 | 0 | 5.5 | | | | | | 29.83 | |
| Alasdair Rankin (Convener) | | 10 | 3 | 0 | 1 | 3 | | 0 | 0 | 1.5 | 8 | | 3 | 0 | 1 | 11.25 | 5.5 | | | | | | | | 47.25 | |
| Cameron Rose | | | 3 | 0 | 0.5 | 1 | 3 | | 0 | 0.5 | 1.5 | 0 | | 0 | 0.5 | 1 | 11.25 | 0 | | | | | | 10 | 32.25 | |
| John Anzani | | | 3 | 0 | 1 | 3 | | 0 | 0 | 1.5 | 5 | | 3 | 0 | 0 | 11.25 | 5.5 | | | | | | | | 4 | 37.25 |
| Richard Lamont | | | 0 | 0 | 1 | 3 | | 0 | 0 | 1.5 | 8 | | 3 | 0 | 1 | 0 | 0 | | | | | | | | 24 | 41.5 |
| Lothian Pension Funds' Pension Board | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Employer Representatives | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Eric Adair (EDI Group) | | | 3 | 0 | 0 | 3 | | | 0 | 1.5 | | | 0 | 0 | 0 | 0 | 0 | 0 | | | | | | | 4.5 | 12 |
| Linda McDonald (Handicabs) | | | 0 | 1.25 | 1 | resigned from board | | | | | | | | | | | | | | | | | | | | N/A |
| Darren May (Scottish Water) | | | 3 | 0.75 | 1 | 3 | | | 0.5 | 1 | | | 3 | 0.83 | 0 | 1 | 0 | 5.5 | | | | | | | 5.5 | 25.08 |
| Rucelle Soutar (the Edinburgh Military Tattoo) | | | 0 | 0 | 1 | resigned from board | | | | | | | | | | | | | | | | | | | | N/A |
| Sharon Dalli (joined September 2016) | 7 | | | | 0 | 0 | | 0.92 | 0 | 1.5 | | | 0 | 0.83 | 0 | 1 | 0 | 5.5 | | | | | | | 22 | 38.75 |
| Alan Williamson (joined September 2016) | 7 | | | | 0 | 3 | | | 0 | 1.5 | | | 3 | | 0.5 | 1 | 0 | 5.5 | | | | | | | 2 | 23.5 |
| Paul Ritchie (joined September 2016) | 7 | | 0 | 0 | 0 | 3 | | | 0 | 1.5 | | | 3 | 0.25 | 0 | 1 | 0 | 0 | | | | | | | 2 | 17.75 |
| Member Representatives | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Graeme Turnbull (UCATT) | | | 0 | 0.75 | 1 | 0 | | | 0 | 0 | | | 3 | | 0 | 1 | 0 | 0 | | | | | | | Resigned 25/01/17 | 5.75 |
| John Rodgers (UNITE) | | | 3 | 0.5 | 1 | 3 | 0.75 | | 0 | 1.5 | | | 3 | 1.16 | 0 | 1 | 0 | 0 | | | | | | | 1.5 | 16.41 |
| Jim Anderson (UNISON) | | | 3 | 1.25 | 0.5 | 1 | 3 | 1.25 | 0.5 | 1.5 | | | 3 | 1.16 | 0 | 1 | 11.25 | 5.5 | | | | | | | | 33.91 |
| Catrina Warren (UNISON) | | | 0 | 0 | 0 | 3 | | | 0 | 0 | | | 3 | | 0.5 | 1 | 0 | 5.5 | | | | | | | | 13 |
| Thomas Carr Pollock (GMB) | | | 0 | 0 | 1 | 3 | | | 0 | 1.5 | | | 0 | | 0 | 1 | 0 | 5.5 | | | | | | | | 12 |
| Total | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 198.15 | | | | | | | | | | | | | | | | | | | | | | | | | | |

*Please note 1/2 an hour preparation is given to all those that attend the audit sub committee. 1 hour is given to those who attend the Pensions Committee.

Clr Rose on LAPFF behalf attended the SSE AGM 21 July (2 hours) and the National Grid AGM 25 July (2 hours)
Clr Rose - LAPFF meeting 5 October (3 hours), LAPFF meeting 18 October (3 hours)

Alan Williamson and Paul Ritchie Induction training Tuesday 6 September 2016 (2 hours). Sharon Dalli is credited for 1 hour for induction training.
September Pension Committee attendees credited with additional 1/2 hour for actuary training during committee.

John Anzani 15/06/2016 PLSA Scotland event - (2 hours) and 02/08/16 PLSA Scotland event - (2 hours)

Eric Adair LGC Seminar 27 October 2016 - (4.5 hours)

Darren May additional reading e.g. Professional Pensions - (5.5 hours over 6 months)

Richard Lamont - additional training, 2/8/16 Shepherd and Wedderburn LLP - (2 hours), 29/11/16 - Trustee training for British tourist board Pension Fund - (4 hours), Trustee Meetings British Tourist Board 26/5, 30/11, 23/8 - (18 hours)

John Rodgers - additional training at Atria 27/01/17 - (1.5 hours)

Sharon Dalli - 21 hours for her work on the auto enrolment group and SAB work.

Local Government Pension Scheme 2015/16



ACCOUNTS COMMISSION 

1. This supplement accompanies our Financial Overview of Local Government in Scotland 2015/16.
2. There are 11 council administered Local Government Pension Scheme (LGPS) pension funds in Scotland. They range from one of the biggest pension funds in the UK (Strathclyde) to one of the smallest (Orkney). Key LGPS facts are shown in [Exhibit 1](#).

Exhibit 1

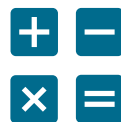
Scottish Local Government Pension Scheme—key numbers

Membership



Active **226,000**
Deferred¹ **126,000**
Pensioner **169,000**

Assets and liabilities



Position
£34.5 billion assets
£41.8 billion liabilities
(estimate)

Transactions



£1.1 billion benefits paid
£0.94 billion employer contributions
£0.27 billion employee contributions
£0.68 billion return on investments

Note: 1 Deferred pensioners are members who have left the scheme but will be eligible for benefits upon reaching retirement age

3. It has been a challenging year for the LGPS in Scotland with the introduction of the new career average revalued earnings (CARE) scheme from 1 April 2015, new governance arrangements at UK, Scotland and local levels and uncertainty in investment markets affecting invest returns.

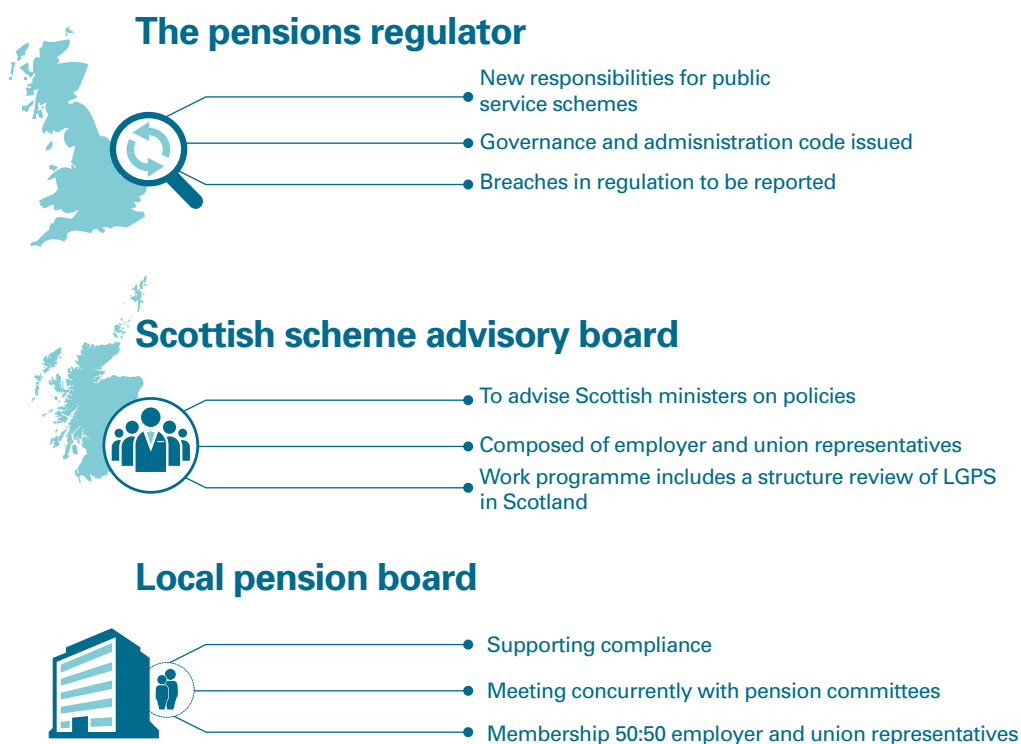
4. Pension funds are required by regulation to produce an annual report and accounts and these are audited separately from the accounts of the administering council. Auditors' deemed the 2015/16 annual accounts of all 11 pensions funds to be true and fair.

Governance arrangements

5. The Public Service Pensions Act 2013 introduced significant changes to the governance framework for public service pension schemes and for the LGPS in Scotland. [Exhibit 2](#) sets out the key changes to governance in 2015.

Exhibit 2

New LGPS governance arrangements in Scotland 2015



6. The Pensions Regulator has issued a code of practice for public sector schemes and pension funds in Scotland continue to monitor compliance with the new code assisted by local pension boards. Fund managers and advisors have a statutory responsibility to report significant breaches to the Pensions Regulator. We have not been made aware of any reports in respect of breaches in 2015/16.

7. The Scheme Advisory Board has a comprehensive programme of work and is planning to review of the LGPS structure in Scotland during 2016-17. Its review will include consideration of collective investment vehicles and the asset pooling model adopted in England and Wales.

8. At a local level all funds introduced pension boards. The role of pension boards is to support pension committees on compliance with regulations and codes. The role pension boards can play is developing, but it is clear they can also provide a useful scrutiny function. Auditors will be expected to monitor the operation of pension boards.

The new Career Average Revalued Earnings LGPS 2015

9. A new Scottish Local Government Pension Scheme was introduced on 1 April 2015. The key changes include:

- a move to benefits being worked out using career average (CARE) rather than final salary
- pension is built up at a rate of 1/49th of annual pensionable pay
- member's normal retirement age being linked to their own State Pension Age.
- A cost-control mechanism will be implemented to make sure the Scheme remains affordable and sustainable in the future.

10. Pension funds have coped well with the introduction of the new CARE LGPS with only minor teething issues reported by auditors. However, there are ongoing challenges in relation to the new scheme as record keeping is more complex than for final salary schemes and there is greater dependency on employers for complete and accurate information. Pension calculations for existing older members will be complex as many will have benefits accrued under the new 2015 scheme (based on CARE and 1/49ths) the previous 2009 scheme (based on final salary and 1/60ths) and the 1998 scheme (based on final salary and 1/80ths).

Cost control under the LGPS 2015

11. The new LGPS 2015 includes a cost control mechanism designed to ensure that the LGPS remains affordable for employers. Under this arrangement, the Government's Actuary Department (GAD) has established a Scottish LGPS cost cap of 15.5 per cent for employers (on a whole scheme basis). If the cost in relation to future service increases by more than two per cent above the employer cost cap, then employee contributions and/or benefits will be reviewed. We understand that employer cost cap costs will next be appraised by GAD following the 2017 triennial valuation and that the earliest cost sharing could start would be 2019.

Investment returns and expenses 2015/16

12. A number of LGPS funds saw negative investment returns on their assets in 2015/16, as shown in [Exhibit 3 \(page 4\)](#). This was influenced by increased uncertainty in global investment markets, low inflation and low growth. The outlook for investment management remains challenging with ongoing volatility and uncertainty in global markets following important events such as Brexit and the US presidential election.

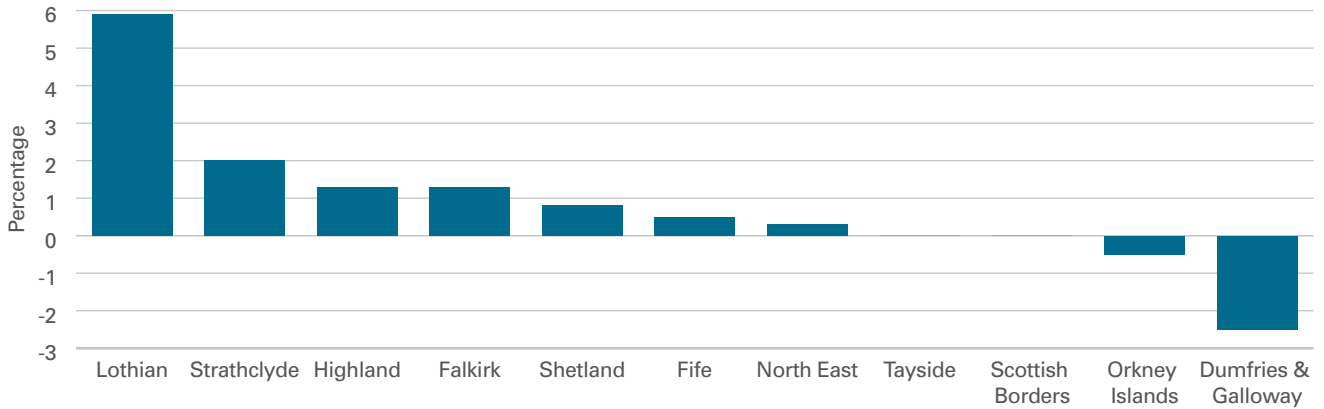
13. Although pension funds manage their investments in line with the same regulatory and governance regimes they have differing strategies and arrangements. Investment management is a complex area and funds make use of external advisers and managers. The full costs of investment management are not always fully transparent and there has been increased scrutiny and changes to guidance around accounting for these costs in recent years.

14. In 2015/16 we saw a divergence in approach by pension funds to the inclusion of investment management expenses in their annual accounts. Revised accounting guidance for 2016/17 emphasises that pension funds' financial statements should only include costs for which they are directly liable, or are within their control. The Accounts Commission is encouraged by the commitment of Scottish funds to full transparency around investment management costs charged and supports indirect expenses being reported in the wider annual report.

Exhibit 3

LGPS pension funds – Net return on investment 2015/16

In 2015/16, four funds saw negative returns on investments.



Source: Pension Fund accounts 2015/16

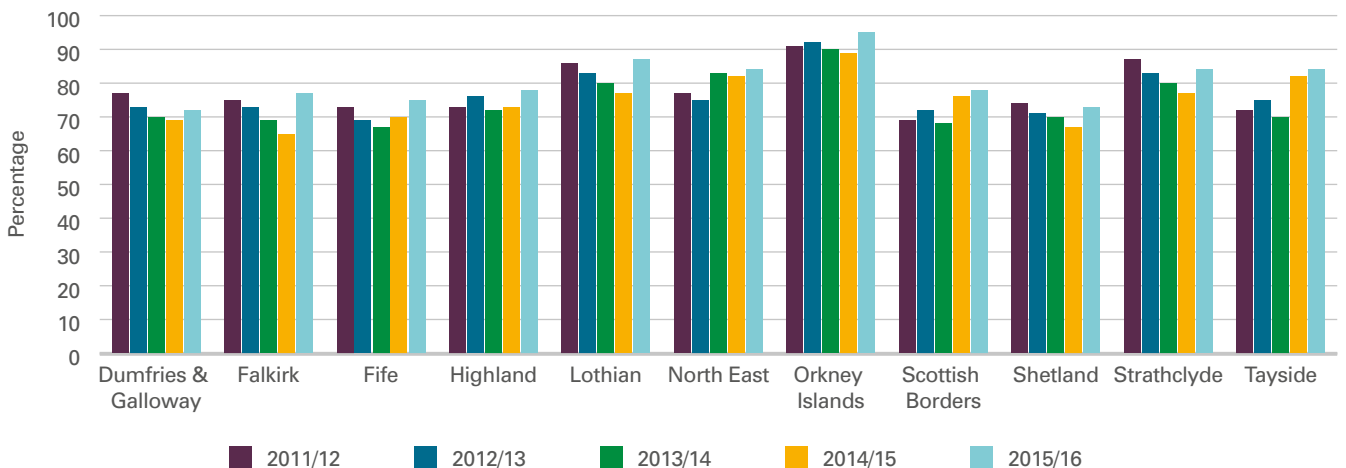
Present value of promised retirement benefits

15. Pension fund accounts include a disclosure of the present value of promised retirement benefits. This value of this liability is an estimate made by actuaries based on a number of assumptions about the future and the figure is quite sensitive to changes to those assumptions. The Liability can be compared with the assets of the pension fund at a point in time and [Exhibit 4](#) shows the valuation of pension fund assets as a proportion of liabilities for each of the last five years.

Exhibit 4

Pension fund assets as a proportion of the present value of promised retirement benefits

The position of all funds improved in 2015/16.



Note: The Scottish weighted average is close to that for Strathclyde which is by far the biggest pension fund in Scotland and one of the biggest in the UK.

Source: Pension Fund accounts 2011/12–2015/16

16. The percentages shown in [Exhibit 4](#) will typically be lower than those calculated by actuaries for the triennial funding valuations which are then used to set employer contributions. This is because the assumptions that can be used for accounting purposes are more tightly prescribed.

17. The overall Scottish LGPS net pension deficit at 31 March 2016 was £7.3 billion. Pension fund deficits are included in employers' accounts. Pension funds have arrangements to recover deficits over periods of up to 20 years in some cases, depending on the risk status associated with individual employers.

18. Pension deficits and employer contributions are complex areas and it can be difficult to establish differences between pension funds from their annual reports. Greater transparency and consistency of reporting in this an area would be beneficial to an understanding of the LGPS in Scotland.

Outlook

19. At a time when councils are under increasing financial pressure, administrative workloads will remain high as councils: continue to reduce their workforces and deal with auto enrolment; refine how they administer the new LGPS; embrace new online technologies to improve information flows with employers and members; deal with recent changes to pension scheme governance; and changes to the UK state pension arrangements.

20. The low inflation and low growth economic outlook together with uncertainty on the financial markets means that investment management will remain challenging at a time when investment performance is key.

21. The new cost control mechanism should help ensure that the LGPS remains affordable for employers in respect of active members although it does nothing to reduce the costs of pensions in payment and the associated deficits.

22. The Scottish Scheme Advisory Board is currently undertaking a structural review of the LGPS in Scotland. The outcome of this review is clearly of pivotal importance to the shape of the scheme and to administration costs going forward.



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