

**FALKIRK COUNCIL**

**Subject: GENERAL GOVERNANCE MATTERS**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 24 SEPTEMBER 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

1.1 This report updates the Board and Committee on miscellaneous matters associated with the business of Falkirk Council Pension Fund.

**2. INTERNAL AUDIT REPORT**

2.1 An Internal audit report on 'Pension Administration and Pension Fund Governance' was submitted to management on the 15<sup>th</sup> of July 2015. The review focused on fund governance and arrangements for the calculations of new member contribution, paying/receiving transfer values and making leaver payment.

2.2 Internal Audit provided substantial assurance in relation to the adequacy of arrangements for Fund governance and for processing of pension related transactions.

2.3 Internal audit set out two recommendations:

- Establishing a Register of Interest
- Addressing risk management points

2.4 A copy of the report is appended and Internal Audit will attend the meeting.

**3. PETROBRAS – CLASS ACTIONS**

3.1 A report on this was considered by the 12 March 2015 meeting of the Pensions Panel and Committee. It was noted that the New York based firm of Robbins Geller Rudman & Dowd, which advises the Council on USA based actions, had estimated the Council's losses at \$7m.

3.2 The Committee agreed to delegate the final decision on participating to the Chief Finance Officer. In the interim, following direct conversation with the legal firm and with advice from Lothian, I have agreed that the legal firm would initiate a Stand Still Action. This protects the Council's position if we elect to opt out of the class action, but does not commit the Council to anything.

3.3 It is the nature of such actions, particularly one of this scale and complexity, that the matter will progress over years rather than months. I will keep the Board and Committee informed.

#### **4. LOCAL GOVERNMENT PENSION SCHEME ADVISORY BOARD**

4.1 The second meeting of the national Scheme Advisory Board was held in Edinburgh on 27 August. The following paras summarise the key items of business.

4.2 Mr Swinney, Depute First Minister, has approved the Board's draft Work Plan, and in so doing, also directed that the Board should:-

“ (i) pay very early attention on both the impact of fund administrator's policies on setting employer contribution rates for non-local government bodies and its approach to cessation charges. I would be interested in an early report on this particular issue which should include significant input from the affected bodies;

(ii) that in due course I would be interested in the Board's views on the merits of merging or pooling funds' assets, noting that the UK government is taking a particularly directive approach to that issue;

(iii) whilst recognising the merits of the Board's bi-partite composition, it is important that there is very close working between the Board and the SPPA on matters of policy. SPPA acts as a custodian of the LGPS regulations on my behalf and therefore I expect there to be clear evidence of that close working relationship.”

4.3 A template is being agreed that will allow the collection of data across Scottish Funds in a consistent manner and facilitate benchmarking. This would in turn feed into workstreams considering how transparency of investment decisions might be approved and the structure of the Scottish LGPS.

4.4 A QC's opinion on Trustee's fiduciary duty would be pursued so that a contemporary Scottish legal opinion is obtained to match the position in England. This clearly will be an important reference point for the Fund's consideration of Ethical, Social & Governance (ESG) matters and will feed into the current Investment Strategy Review by the Sub Group.

4.5 The Government Actuary's Department (GAD) is pursuing work on the Cost Cap Mechanism, based on the 2014 valuation data, consistent with the requirement of the Public Service Pensions Act 2013. The importance of this is that if the measure is +/- 2% from the original Cost Gap then:-

- Change in reformed scheme benefits
- Change in member contributions
- Default is a change in the accrual rate

## **5. THE PENSIONS REGULATOR**

5.1 The jurisdiction of the Pension Regulator now extends to the LGPS and this brings with it responsibilities for reporting breaches of the Law. This as noted below could potentially be quite onerous.

5.2 Examples of breaches are:-

- Failure of an employer to pay over member and employer contributions on time
- Failure to pay member benefits either accurately or in a timely manner
- Failure to maintain accurate records
- Failure to issue annual benefit statements on time.

Consideration would need to be given to materiality.

5.3 The responsibility to report any such breach is wide and extends to all individuals with a role in the LGPS. This therefore would include the scheme manager, pension board members, scheme employers and professional advisers, including the actuary.

5.4 Whilst it is expected that the Regulator may adopt a light touch in the early days, the Fund will need to ensure its monitoring and tracking processes are fit for purpose.

## **6. LOCAL AUTHORITY PENSIONS FUND FORUM (LAPFF)**

6.1 The LAPFF represents the interests of 65 local authority pension funds with combined assets of around £165 billion. Its mission is to promote the highest standards of corporate responsibility amongst the companies in which member funds invest.

6.2 The LAPFF is supported by PIRC Ltd, who are the Forum's company research and engagement partner. PIRC are also the Falkirk Fund's proxy voting agents and advisers on ESG matters.

6.3 As part of its lobbying activities, LAPFF is a leading participant in the "Aiming for A" campaign – a coalition of asset owners with shared concerns over the environmental dangers of climate change and the long term profitability of carbon intensive energy companies.

6.4 The campaign has prompted unprecedented level of support for shareholders resolutions on strategic resilience at the BP and Shell AGMs. The resolutions included a request for an assessment of the companies' asset portfolio resilience against the range of International Energy Agency scenarios. A voting alert was issued for similar resolutions to the Statoil and similar issues highlighted for Chevron, Anadarko and ExxonMobil.

6.5 Other LAPFF activity during the last quarter included:

- Meeting with the chairman of Barclays regarding remuneration committee chairman and accounting standards

- LAPFF representatives attended and proposed motions or addressed the board at eight AGMs during the quarter: Rio Tinto (tax transparency and carbon management), British American Tobacco (health), Carillion & Balfour Beatty (labour supply chain), Next (supply chain))
- Following LAPFF letter to Tesco regarding linkage between executive remuneration and good governance, Tesco announced provisions to claw back bonuses from its CEO and Finance Director
- Raising concerns over employment standards and human rights at National Express AGM

6.6 Following discussions at the last Committee meeting, Councillors Blackwood and Coleman have agreed to attend the LAPFF Annual Conference in Bournemouth on 2<sup>nd</sup> – 4<sup>th</sup> December, 2015.

## 7. RECOMMENDATION

7.1 The Pensions Committee and Pensions Board are invited to note the content of this report.

pp Director of Corporate & Housing Services

Date: 14 September 2015

Contact Officer: Bryan Smail

### LIST OF BACKGROUND PAPERS

NIL

**FALKIRK COUNCIL**

**INTERNAL AUDIT REPORT**



# **Falkirk Council**

**2015/16 INTERNAL AUDIT REVIEW**

**PENSION ADMINISTRATION AND PENSION FUND GOVERNANCE**

<b>Overall Assurance</b>	<b>SUBSTANTIAL ASSURANCE</b>
<b>Auditor</b>	Graham Templeton, Senior Internal Auditor
<b>Report Recipients</b>	Bryan Smail, Chief Finance Officer Amanda Templeman, Acting Depute Chief Finance Officer (Corporate Finance) Alastair McGirr, Pensions Manager
<b>Date</b>	15 July 2015

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## 1. INTRODUCTION AND SCOPE

1.1 This review of Pension Fund Governance and the arrangements for processing pension related transactions forms part of our 2015/16 Internal Audit coverage, agreed by the Audit Committee in April 2015.

1.2 Internal Audit, in conjunction with the Pensions Manager, identified the key risks relating to pensions governance and transactions, and agreed Terms of Reference for the review (**Annex 1**).

1.3 Falkirk Council is the Administering Authority for the Falkirk Council Pension Fund (the Fund). The Council is responsible for ensuring that Fund business is legal and in accordance with pension standards. The Fund is used to pay pension, lump sum benefits, and other entitlements to scheme members and their dependants. Contributions to the Fund are made by active members (ie employees) and by participating employers. The Fund also receives income from the assets it holds, which includes equities, property, and bonds.

1.4 Fund membership (see **Table 1**) is made up of active, deferred, and pensioner members. To be eligible for fund membership individuals must be an employee of a participating employer and not eligible to join one of the other public sector pension schemes. In addition to Falkirk Council, participating employers (referred to as either Scheduled or Admission Bodies) include Clackmannanshire and Stirling Councils, Central Scotland Valuation Joint Board, the Scottish Children's Reporter Administration, the Scottish Environment Protection Agency, Forth Valley College, Falkirk Community Trust, and a number of charitable bodies.

**Table 1**  
**Scheme Membership at 31 March 2015**

<b>Active</b>	<b>Deferred</b>	<b>Pensioners</b>	<b>Total</b>
<b>14,589</b>	<b>5,405</b>	<b>8,995</b>	<b>28,989</b>

1.5 There have been a number of recent reforms and changes to pensions. The majority of these were as a result of the Public Service Pensions Act 2013. The reforms and changes include auto enrolment and the change in the Local Government Pension Scheme from a final salary to a career average basis from 01 April 2015.

1.6 Administration is undertaken by the Falkirk Council Pensions Section. The reforms and changes referred to above have meant the Pensions Section has had to procure and implement a new Pensions Administration System. In addition, new corporate governance arrangements for the management of the Fund took effect from 01 April 2015.

1.7 This review has focussed on fund governance, and arrangements within the Pensions Section for the calculation of new member contributions; for paying / receiving transfer values; and for making leaver payments.

## **2. AUDIT ASSURANCE AND EXECUTIVE SUMMARY**

2.1 We can provide **SUBSTANTIAL** assurance in relation to the adequacy of arrangements for Fund governance and for the processing of pensions related transactions (see **Annex 2** for a definition of assurance categories).

2.2 We found that the operational controls associated with the calculation of new member contributions; for paying / receiving transfer values; and for making payments were well managed and working effectively. All staff consulted during the review were clear about their roles and responsibilities.

2.3 The governance arrangements for the Fund have recently changed, and we did note some points where there was scope for enhancing the existing framework of control. In particular, we found there to be a need for more robust risk management arrangements, to ensure that risks are better assessed and managed with ownership clearly stated, and for the maintenance of a Register of Interests for Pension Committee and Board members.

2.4 A summary of our recommendations is set out at Section 4 of this report, with more detail provided at Section 3.

### **3. AUDIT FINDINGS**

#### **Remit Item 1: Governance**

3.1 The Council has delegated responsibility for the administration of the Pension Fund (the Fund) to the Pensions Committee (the Committee), with various operational responsibilities falling to the Chief Financial Officer. During 2014/15 the Committee was supported by an advisory Pensions Panel (the Panel).

3.2 Governance arrangements for the Fund have recently changed. The changes (effective from 01 April 2015) were agreed by the Committee and then ratified by full Council in December 2014. Changes include the establishment of a Pensions Board (the Board) and the discontinuing of the Panel. The Committee configuration has remained unchanged. The Board's constitution was agreed at a joint meeting of the Committee and Board in June 2015. While the Board may convene its own meetings, the expectation is that the Board will meet jointly with the Committee.

3.3 The Fund Governance Policy (the Policy), which includes the statutory Governance Compliance Statement, has been updated to reflect the recent changes. The Policy was also agreed at the inaugural joint meeting of the Committee and Board in June 2015.

3.4 Investment Management of the Fund's assets is undertaken by external fund managers. The Pensions Section oversees this, with the support of the Fund's appointed investment adviser Hymans Robertson. Additional support is provided through a resourcing agreement with the Lothian Pension Fund. The Committee meets on a quarterly basis to review external fund manager actions and performance. In addition, the Fund measures its performance against a number of standards. Performance information is supplied to Scottish Government and CIPFA, and is included within the Annual Report.

3.5 The Fund's Investment Strategy is currently being reviewed, and a report was presented to the March 2015 Committee on the level of risk associated with various strategies, the options for reducing risk, and how the chosen strategy can be put into practice. The review will focus on ways to reduce exposure to riskier assets without compromising the Fund's prospects of returning to fully funded status in the medium to long term. The agreed changes

will result in a revised Statement of Investment Principles once the Investment Strategy review is concluded.

3.6 The unaudited Annual Report and Accounts for 2014/15 confirm that a Conflicts of Interest Policy will be prepared during 2015/16. Conflicts of Interest are a standing agenda item at Committee / Board meetings. To supplement this, we **recommend** that a Register of Interests is established to record details of any actual / potential conflicts relating to members of the Committee and the Board. The Register should be published on the Fund's website.

3.7 At an operational level, roles and responsibilities were well understood by Pensions Section staff. Operational procedures are in place, and these are being updated to reflect the revised processes established following implementation of the new Pensions Administration System. A range of key performance indicators, in relation to membership and benefits administration, are monitored by the Pensions Manager, and these are summarised in the Annual Report and Accounts. The performance indicators will be reviewed by the Pensions Manager as the new Pensions Administration System is developed.

## **Remit Item 2: Risk Management Arrangements**

3.8 The Policy summarises risk management arrangements in relation to Fund activities. The Pension Fund Risk Register focuses mainly on the risks to the administrative functions, and the Board is advised of any significant changes in risk level as well as the reason for the change. Investment risks are detailed in the Statement of Investment Principles, and risks also feature in the Funding Strategy Statement.

3.9 A commitment is made in the unaudited 2014/15 Annual Report and Accounts that the Pensions Section will review risk management over the coming year. In undertaking this review, we **recommend** that the following points are considered:

3.9.1 the risks detailed in the Statement of Investment Principles and Funding Strategy Statement have no specific owner, ranking, or score. It is also not stated how movement in these risks are reported to the Committee / Board; and

3.9.2 the Risk Register does not reflect the current live risk position. In future, the Board should be advised of the change to the risk score to enable the Board to quantify

the scope of any movement, and the Risk Register should be updated on an ongoing basis.

### **Remit Item 3: Arrangements for the actuarial valuation of the Pension Fund**

3.10 The actuarial valuation of the Pension Fund is undertaken every three years. The valuation determines the financial position of the Fund and sets an appropriate rate of employers' contributions for the next three years. The last actuarial valuation, carried out by Hymans Robertson, covered the period to 31 March 2014. The key results from the 2011 and 2014 valuations are summarised in Table 2.

**Table 2**  
**Actuarial Valuation**

	<b>Valuation at 31 March 2011</b>	<b>Valuation at 31 March 2014</b>
Past Service Liabilities	£1,392m	£1,860m
Assets	£1,199m	£1,577m
Funding Deficit	£193m	£283m
<b>Funding Level</b>	<b>86.1%</b>	<b>84.8%</b>

3.11 The results from the actuarial valuation were reported to the Committee / Panel in March 2015. The 2014 valuation showed that the Fund is 85% funded (meaning that it has 85% of monies needed to pay all the future benefits of scheme members based on the rights that they had accumulated to that date).

3.12 The valuation also highlighted that, whilst asset performance between 2011–2014 was significantly better than the return targeted, this had been outstripped by an increase in fund liabilities. The Council's approach to funding scheme liabilities is set out in the Funding Strategy Statement which was agreed by the Committee / Panel in March 2015. During 2014/15, the Fund has increased its exposure to alternative assets by making a £30m commitment to Social and Affordable Housing, and a further £30m commitment to be invested in UK infrastructure.

3.13 A further estimated funding position, as at 31 March 2015, was provided to the Committee / Board at the June 2015 meeting.

#### **Remit Item 4: Guidance and Training**

3.14 Various seminars, conferences, and in-house training events are made available to Committee / Board members. This includes the Falkirk Council Pension Fund annual conference. The current Pension Fund Training Policy was approved by the (then) Investment Committee in March 2012, and the unaudited Annual Report and Accounts for 2014/15 confirm that training arrangements will be addressed during 2015/16.

3.15 The new Board met for the first time in June 2015. Arrangements are being made for Board members to be provided with training. It is also recognised that the Training Policy will require to be updated and that training arrangements will continue to be broad-based to support member decision making.

#### **Remit Item 5: Transactional Arrangements**

##### **New Members**

3.16 We reviewed a sample of recent applications and were content that these had been processed accurately. A new member notification form is completed by the employee and employer and submitted to the Pensions Section. The form is checked by the Pensions Section, in particular to ensure that pensionable pay and the contribution rates are correct. Member details are added to the Pensions Administration System and a welcome pack (that includes the statutory notification form) is sent to the employee.

##### **Paying / receiving transfer values**

3.17 Arrangements for the payment and receipt of transfer values were sound. Transfers can fall into three categories: inter-fund adjustments (from other Local Authority funds); public sector scheme transfer (from other public sector funds); and private sector pension transfers.

3.18 When paying out transfer values the Pensions Section will receive a request for a transfer value (usually from the other pension scheme or a financial adviser on behalf of the employee). The transfer value is then calculated and statement of entitlement, transfer information sheet, and transfer request / discharge forms are issued. For inter-fund transfers,

an inter-fund adjustment calculation is issued. The transfer will proceed on receipt of the authorised transfer form.

3.19 For transfers into the Fund the Pensions Section become aware of these once the member has joined and indicated that they have previous pension rights. If the member confirms they are interested in transferring, a request is made to the other pension scheme(s) for confirmation of the pension value and duration of membership (for inter-fund adjustments a transfer value is received). This information is then used by the Pensions Section to calculate the adjusted transfer value / number of days service. Details of the calculation are recorded (on the service credit working paper) and the member is advised of these details in writing. The member also has to confirm in writing if they want to proceed.

3.20 We tested a sample of recent transfers (both payments and receipts) and were content that the necessary supporting documentation was available, had been appropriately completed and authorised, and that the correct value of funds had been received or paid out.

### **Pension Payments**

3.21 Once the Pensions Section are notified of a leaver or retirement, a statement of pensionable remuneration is issued by the relevant payroll department with their final salary details.

3.22 Where the individual is retiring the Pensions Section write to them to confirm how they wish to receive their retirement benefits. This information is included in a retirement pack which consists of a pension enrolment form, lifetime allowance declaration, and lump sum request form. Prior to this, the value of the annual pension, monthly pension, and lump sum is checked by the Pensions Officer.

3.23 We tested a number of pension payments (including lump sums), and were content that they had been correctly calculated and had been appropriately completed and authorised.

#### 4. RECOMMENDATIONS AND ACTION PLAN

Rec No.	Recommendation	Reason for Recommendation	Agreed Management Action	Responsible Owner	Action Due
1.	<p>A Register of Interests should be established to record details of any actual / potential conflicts relating to members of the Committee and the Board.</p> <p>The Register should be published on the Fund's website.</p> <p><b>Report Paragraph: 3.6</b></p>	<p>To ensure that any dual interests or responsibilities are being recorded and monitored on an ongoing basis.</p>	<p><b>Recommendation Accepted</b></p> <p>Once the Conflicts of Interest Policy has been agreed the Democratic Services Manager and the Pensions Manager will discuss further.</p>	<p>Democratic Services Manager / Pensions Manager</p>	<p>31 March 2016</p>
2.	<p>The points in relation to the risk ownership, ranking, and score; and updating the risk register for the Fund; should be addressed.</p> <p><b>Report Paragraph: 3.9</b></p>	<p>To demonstrate that all risks are being identified, assessed and managed.</p>	<p><b>Recommendation Accepted</b></p> <p>The risk management points will be addressed.</p>	<p>Pensions Manager</p>	<p>31 March 2016</p>

## Terms of Reference



<b>Service:</b>	Chief Executive Office – Finance Services	<b>Audit Year:</b>	2015/16
<b>Depute CFO:</b>	Amanda Templeman	<b>Audit Manager:</b>	Gordon O'Connor
<b>Manager:</b>	Alastair McGirr	<b>Lead Auditor:</b>	Graham Templeton
<b>Audit Area:</b>	Pension Administration and Pension Fund – Governance Arrangements		

### SCOPE

The scope of this review was to evaluate and report on controls established to manage the risks relating to the governance and management of the Falkirk Council Pension Fund and the processing of pension related transactions. This review formed part of our 2015/16 coverage of Falkirk Council, agreed by the Audit Committee on 20 April 2015.

### KEY RISKS

These are the key risks that could exist if the main elements of the internal control framework are not in place. The purpose of the review was to assess the adequacy of the controls established to manage these risks. The following were identified as key risks:

- lack of clarity in Pension Fund Governance arrangements results in poor investment decisions and / or non compliance with legislation and codes of practice;
- lines of accountability poorly defined or unclear, results in pension fund risks not being identified, prioritised, and managed in a coordinated manner;
- pressure of fund assets, resulting in adverse impact on Council budgets;
- lack of guidance and training, leading to poor administration of the Pension Fund and resulting in non-compliance with legislation, best practice, or Financial Regulations; and
- lack of clarity in pension transaction processing roles and responsibilities, resulting in financial loss and / or not meeting customer requirements.

### REMIT ITEMS

We developed our audit work-plan to obtain the necessary evidence to provide assurance that appropriate systems are in place to mitigate the above risks. This was done by reviewing the following:

1. Pension Fund governance. To include roles and responsibilities of the Pensions Committee, Pensions Panel / Board, and professional advisers;
2. Pension Fund risk management arrangements;
3. Arrangements for the actuarial valuation of the Pension Fund;
4. Guidance and training. To include Pensions Committee and Pensions Board members, as well as Council staff.
5. Roles and responsibilities of those involved in:
  - ensuring that new member contributions are properly calculated;
  - paying / receiving transfer values; and
  - pension payments (including lump sum payments).

This included testing of a sample of transactions, and reviewing the adequacy of supporting policies and procedures.

**DEFINITION OF ASSURANCE CATEGORIES**

<b>Level of Assurance</b>	<b>Definition</b>
<b>Substantial assurance</b>	Largely satisfactory risk, control, and governance systems are in place. There may be some scope for improvement as current arrangements may undermine the achievement of objectives or leave them vulnerable to error or abuse.
<b>Limited assurance</b>	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or abuse.
<b>No assurance</b>	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or abuse is unacceptable. Significant improvements are required.