	Pension Fund Sub Committee 28February 2012 **Report from the Director of Finance and Corporate Resources**
For Action	Wards Affected: ALL
	CIPFA Code of Practice – Public Sector Pensions Finance Knowledge and Skills

1. SUMMARY

The report details the CIPFA Knowledge and Skills Code of Practice and its implementation at Brent Council.

2. RECOMMENDATIONS

Members are asked to note the report and agree:-

a) The adoption of the Key Principles, Statement and Policy Statement and
b) The requirement to undertake regular learning and development on pensions finance knowledge and skills
c) The target of 21 hours per annum for learning and development.

3 DETAIL

Background

3.1 CIPFA published a Knowledge and Skill Framework in 2010 to promote good governance in public sector pension scheme decision making bodies by providing a framework for the training and development of staff and members. Members agreed proposals to improve learning and development opportunities and commitment, and for a questionnaire to assess individual requirements.

3.2 Progress in improving learning and development has been mixed. Officers, for whom this is a day to day activity, have used the web based package produced by the actuary, AonHewitt, and attended relevant seminars and conferences on accounting, actuarial and investment issues. Members have:-

a) Received induction training.
b) Had access to the online training package produced by AonHewitt
c) Attended a number of training seminars on such subjects as asset allocation, the actuarial valuation, private equity investment, emerging markets and others.
d) Attended some investment conferences (particularly the Chair and the Cabinet member).
e) Received reports on a variety of investment, actuarial and pensions administration topics.
f) Received a questionnaire to assess learning and development requirements.

3.3 However, member attendance at training sessions has been 'patchy', and the questionnaire was not answered.

3.4 CIPFA has now issued a Code of Practice on Public Sector Pensions, Finance Knowledge and Skills. This is being introduced from 1st April 2012, and requires a compliance report to be included in the Annual Report and Accounts for 2012/13. The Key Principles of the Code are:-

a) Organisations responsible for the financial administration of public sector pension schemes recognise that effective financial management, decision making and other aspects of the financial administration of public sector pension schemes can only be achieved where those involved have the requisite knowledge and skills.
b) Organisations have in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective acquisition and retention of public sector pension scheme finance knowledge and skills for those in the organisation responsible for the financial administration and decision making.
c) The associated policies and practices are guided by reference to a comprehensive framework of knowledge and skills requirements such as that set down in the CIPFA Pensions Finance Knowledge and Skills Frameworks.
d) The organisation has designated a named individual to be responsible for ensuring that policies are implemented.

3.5 CIPFA recommends that organisations adopt the following statement:-

1 This organisation adopts the key recommendations of the Code of Practice on Public Sector Pensions Finance Knowledge and Skills.
2 This organisation recognises that effective financial administration and decision making can only be achieved where those involved have the requisite knowledge and skills.
3 Accordingly this organisation will ensure that it has formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective acquisition and retention of the relevant public sector pension scheme finance knowledge and skills for those in the organisation responsible for financial administration and decision making.
4 These policies and practices ill be guided by reference to a comprehensive framework of knowledge and skills requirements such as that set down in the CIPFA Pensions Finance Knowledge and Skills Frameworks.
5 This organisation will report on an annual basis how these policies have been put into practice throughout the financial year.
6 This organisation has delegated the responsibility for the implementation of the requirements of the CIPFA Code of Practice to the Director of Finance & Corporate Services (supported by the Head of Exchequer & Investment), who will act in accordance with the organisation's policy statement, and, where they are a CIPFA member, with the CIPFA Standards of Professional Practice.

3.6 CIPFA also recommends that councils adopt the following knowledge and skills Policy Statement:-

a) This organisation recognises the importance of ensuring that all staff and members charged with the financial administration and decision making with regard to the pension scheme are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them.
b) It therefore seeks to utilise individuals who are both capable and experienced and it will provide / arrange training for staff and members of the pension decision making body to

enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

3.7 It is recommended that both the Key Principles and the Policy Statement be included in the Statement of Investment Principles. It is planned that the 2011/12 Report and Accounts will report on learning and development in line with the CIPFA Code of Practice.

3.8 The practical issue is how to support the improvement of knowledge and skills? Officers have access to reading materials, and have been able to attend a number of seminars and conferences over a long period. It is more difficult for members, who have numerous pressures on their time. However, it is suggested that there are a number of ways in which knowledge and skill levels can be increased:-

a) Use of the web-based packages and CIPFA repository, when developed. The council has recently appointed Hymans Robertson as actuary under the Croydon Framework for actuarial services. Hymans Robertson offers a web-based training package, similar to that offered by AonHewitt. The Croydon Framework offer learning opportunities for members that will be publicised.
b) Manager or actuary led training sessions (either at sub committee meetings or separately), or specific training / for information items as part of the agenda. The Work Plan for the Sub Committee follows this approach. Further, over a period, many of the investment, legal and procurement issues are covered with Sub Committee agendas. This is probably the most important area of learning and development. The Head of Exchequer & Investment is always happy to give briefings on investment issues or new development.
c) An improved induction training package produced by the Head of Exchequer and Investment that covers more of the areas outlined in the CIPFA Framework. New members are offered induction training when they join the Sub Committee. A briefing note has been attached as Appendix 1 that covers most of the issues that were part of the questionnaire issued to members. It is suggested that members review the note and raise issues with the Head of Exchequer & Investment as necessary.
d) Courses and seminars organised by managers, actuaries, NAPF and other experts. The Chair of the Sub Committee and the Cabinet member have attended the LGC Investment Summit on an annual basis, but I will circulate more opportunities as these become available.
e) Reading materials. If there are particular issues that interest / concern members, my team will be able to find articles or books that can explain them.

3.9 It is proposed that members adopt a target number of hours to be spent annually on learning and development. The London Borough of Hillingdon has adopted a target of three days training (21 hours) per year, based on time spent:-

a) At sub committee meetings (4 hours per meeting), of which there are usually at least five per annum.
b) Training events, or web based training.
c) Seminars / conferences.
d) Briefings.
e) Reading.

The Head of Exchequer & Investment will keep a record of member attendances at sub committee meetings and training events, but members should tell him about other training undertaken.

4. FINANCIAL IMPLICATIONS

4.1 There are no financial implications arising directly from the Framework, though members may wish to attend more seminars and courses.

5 DIVERSITY IMPLICATIONS

5.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

6 STAFFING IMPLICATIONS

6.1 None

7 LEGAL IMPLICATIONS

7.1 There are no legal implications arising from the plans.

8 BACKGROUND

8.1 Previous work programmes for the Sub-Committee.

Report to Pension Fund Sub Committee on the CIPFA Pensions Panel Knowledge and Skills Framework, 29th June 2010

9. CONTACT OFFICERS

9.1 Persons wishing to discuss the above should contact the Exchequer and Investment Section, Brent Financial Services, on 020 8937 1472/74 at Brent Town Hall.

CLIVE HEAPHY
Director of Finance and Corporate Services

MARTIN SPRIGGS
Head of Exchequer and Investment

Guide to members – Pension Fund - Knowledge & Skills Framework

CIPFA introduced the Knowledge & Skills Framework in 2010 to support both members and officers in an area of increasing complexity. The notes below seek to assist officers and members in some areas. It is by no means exhaustive, but will seek to point recipients to documents / sources that can give additional information. The Statement of Investment Principles, and numerous regular monitoring and other reports will also be helpful.

Legislative and governance framework

1 **Awareness of the LGPS (Benefits, Membership and Contributions) Regulations 2007.** Introduced the new LGPS scheme, with the following features:-

a) Graduated contributions for employees (5.5% - 7.5%)
b) Normal retirement at 65, with the exception of ill health no early retirement before age 55.
c) Accrual rate of one sixtieth for each year of service, with no automatic lump sum.
d) Changes to ill health retirement
e) Commutation of pension to lump sum
f) Flexible retirements
g) Improved death benefits

2 **Awareness of the LGPS (Administration) Regulations 2008,** including changes to the investment regulations:-

a) Separate regulations for benefits and administration.
b) The pension fund cannot lend to the administering authority, and must have a separate bank account.
c) The administering authority must produce a separate Annual Report & Accounts, which must include the items set out in 4 below.

3 **Knowledge of the investment principles arising from the Myners' report.** The Myners' report (Pension Fund Sub Committee 2001) set out ten principles of investment that administering authorities should either follow or explain their non-compliance in their Statement of Investment Principles (SIP). The principles have been revised down to six, and are set out in the Statement of Investment Principles. The six principles are:- Effective decision making, clear objectives, risk and liabilities, performance assessment, responsible ownership and transparency & reporting.

4 **General understanding of the Annual Report & Accounts.** The report and accounts must comply with International Financial Reporting Standards, and must include various items as set out in CIPFA advice and guidance. This includes:-

a) Accounts that follow the CIPFA Statement of Recommended Practice, such as details of the use of derivatives.
b) Reference to where the reader can find the various statements that the Fund is required in regulations to produce – the Statement of Investment Principles, the Communications statement, and the Governance Statement.
c) A risk statement
d) Service standards
e) Details of investment performance
f) Information about who to contact
g) Details of member training and attendance at committee meetings
h) A statement by the actuary

5 **Broad understanding of the role of the Pension Fund Sub Committee.** Members of the Sub Committee review the management of the Brent pension fund, both its administration and investment, and take decisions on policy issues affecting the Fund. This will involve:-

a) Administration – receive the Actuarial Valuation report from the actuary and agree future employer contributions, agree the appointment of the administrator (Capita), receive the annual report & accounts.
b) Investment – review performance, review and appoint managers, decide asset allocation, agree new investments
c) Receiving advice and reports from the Director of Finance & Corporate Services and the Independent Adviser.
d) **Not employer functions, such as early retirements**, added years.
e) To be properly trained in their role.

6 **Understand the role and statutory responsibilities of the Director of Finance and Corporate Services.** The Director is the chief financial officer for the authority and has the responsibility for giving financial advice to members and ensuring that expenditure is reasonable and legal. He prepares and presents the annual accounts of the Fund. The role, as it affects the Pension Fund, is set out in the SIP.

7 **Awareness of the Investment regulations.** Aspects of the regulations are set out in the Statement of Investment Principles, but they include such items as:-

a) Limits on investment in various asset classes and managers, to ensure diversification and liquidity, and to reduce risk.
b) Monitoring managers
c) Taking advice

Pensions accounting and auditing standards

8 **Awareness of the accounts and audit regulations and legislative requirements relating to the Annual Report and accounts.** The accounts must be closed by 30th June, and the annual report and accounts (audited) presented by 30th September. There are various requirements and explanations that must be included in the accounts, as set out above.

9 **Awareness of the role of both internal and external audit in the governance and assurance process.** The Brent Fund is audited by both internal and external audit, each having different but complementary roles. Internal audit looks at controls and systems, checking to ensure that these are sound, accurate and reduce risk. External audit examine the final accounts, but check what work has been done by internal audit before deciding their own checking processes. External audit will check that statements and explanations are accurate and complete, and that the accounts give a full and fair view of the transactions of the Fund, bearing in mind statutory requirements.

Procurement of services

10 Although there are occasions when European tendering legislation does not apply, such as investment in a fund rather than specifically appointing a manager, there are clear requirements for the letting of any contract valued at more than approximately £152,000. The tender must allow full competition so that European firms are not disadvantaged in competition with British firms. On that basis, contracts for the Fund above £152,000 must be advertised in the European journal, and must go through set stages before being let – asking contractors to tender, and then asking them to complete a tender questionnaire, giving everyone an equal opportunity, interviews, and having a 'cooling off' period.

11 **Awareness of the nature and scope of risks for the pension fund when selecting third party providers.** Among the main risks are performance issues, standards of provision, failure of the provider, accuracy and fraud. The failures by the provider may affect the reputation of the fund, as well as rendering the fund liable for damages.

Investment performance and risk management

12 The long term risks to the Fund include such issues as:-

a) Performance and falling markets
b) The value of the liabilities
c) The performance of the managers
d) Employer covenant
e) The number and ages of active employees
f) Longevity
g) Interest rates and inflation

13 Awareness of the requirement to monitor both managers' activities and their performance. Members review managers' performance and activities on a quarterly basis, using both bespoke reports (from the in house, overseas equity and fixed interest managers) and summary reports from officers (who meet with or receive reports from managers on a regular basis) to confirm that activity and performance are in line with the mandate and performance benchmarks – or to ascertain reasons if there is deviation.

14 Awareness of the requirements to monitor the performance of both advisers and the sub committee.

a) On the adviser, performance is reviewed on a triennial basis, looking at input at committees, strategic advice and support with monitoring and selecting managers.
b) Members assess their performance on an annual basis (in the Work Plan), looking at learning / development and other activities. The Work Plan covers three years to ensure that activity is fully planned.

15 Awareness of the risk and return characteristics of the various asset classes. The traditional investment mantra has been 'higher risk, higher reward', but this has not been the case in recent years following the bursting of the equity bubble in 2000, and the boom in government bonds as interest rates have fallen to record levels. There should be a distinction between growth assets (such as equities), which grow (in major part) in line with economic growth and are more risky, and matching assets (such as bonds) which are less volatile. The asset classes employed by the Brent Fund are as follows:-

a) Equities are regarded as risky, and traditionally returns have reflected a long term equity risk premium. The Fund is exposed to UK equities (both FTSE350 and small companies) and overseas equities (both developed and emerging markets).
b) Government and corporate bonds, which are less volatile and match liabilities.
c) Credit instruments issued by companies (such as secured loans), which should give some additional return over government gilts, but are subject to credit risk.
d) Property, both UK and in Europe, should be less volatile than equities because it mainly relies on rental growth. However, there are property cycles that mean that the asset class can suffer in an economic downturn.
e) Private equity is correlated to public equity, and is risky. However, the asset class relies on an illiquidity premium (because investment is tied up for a long period) and a skill premium related to the abilities of both the individual and the fund of fund managers.

f) Infrastructure seeks to invest in assets that will grow in value as a result of a monopoly position or through further investment and development. The investment is risky, in line with property, but has skill and illiquidity premia.
g) Hedge funds are absolute return vehicles, seeking to preserve capital and make returns from a variety of strategies. Over the long term they should be fairly low risk, but over the short term there is a 20% / 25% correlation to equities that can make returns volatile.
h) Global Tactical Asset Allocation. Although the fund takes some risk reduction measures in volatile, and invests across markets and assets, the fund is very volatile as a result of leverage (very large positions using derivatives on which only a small deposit is paid) and the use of futures to track the FTSE100.
i) Cash is a low risk asset, and currently generates a very low return.

16 The importance of diversification and the asset allocation strategy. The investment regulations require that the fund must be properly diversified – putting all 'the eggs in one basket' is unwise as managers and individual markets can underperform very sharply. It is also apparent that diversification allows the fund the opportunity to gather outperformance from a number of possible sources, rather than rely on a few. Diversification is an element in asset allocation, but there must also be considerations of risk, growth opportunities, matching assets and different premia – equity risk, illiquidity, skill, monopoly etc. It has been estimated that asset allocation is the key driver of investment returns, being responsible for around 85% of returns. In the past, funds have mainly invested in public equities, bonds and property, but the growth of other opportunities and the over-valuation of equity markets in the dot-com bubble have encouraged investment in alternatives such as hedge funds, private equity and infrastructure. See the Statement of Investment Principles.

17 Awareness of the roles of the independent adviser and investment managers. The main aspects of both roles are set out in the Statement of Investment Principles. The independent adviser provides advice on asset allocation, asset classes and managers. They are involved in manager searches, and join the Director of Finance and Corporate Services in many manager meetings. Investment managers have discretion, and are accountable for, the management of their individual portfolios. They give regular explanations of views and activities, either to members or to the Director of Finance and Corporate Services. Managers may also give advice to members on investment opportunities and markets.

18 Awareness of the performance measurement process. The investment performance of the Brent Fund is measured and reported by WM Company on both a quarterly and an annual basis. The measurer uses benchmarks as comparators. These can be either cash related (e.g LIBOR / LIBID +) or market related (eg FTSE350). In the quarterly report, WM measures both individual manager - looking at stock selection returns - and total fund performance – looking at asset allocation. WM also supplies separately details of the returns for the average local authority fund for additional comparison. On an annual basis, WM compares performance against both the benchmark and the annual fund, analysing performance variations between stock selection and asset allocation.

Financial markets

19 A general awareness of financial markets. Over the long term, growth markets should progress in line with economic growth. However, over the short term, markets may rise and fall sharply.

20 An awareness of the investment limits set out in the LGPS Investment Regulations. These are set out in the Statement of Investment Principles, and seek to ensure diversification and

risk reduction, both for managers and asset classes. For example, exposure to limited partnerships is limited to 15% of the Fund.

Actuarial methods, standards and practices

21 Knowledge of the actuarial process, including the Funding Strategy and inter-valuation monitoring. At each triennial Actuarial Valuation, the actuary examine the previous investment / benefit history of the Fund, and will value assets and liabilities to determine the employer contribution rates that will pay off any deficit within the approved deficit recovery period. The actuary will agree economic, investment return and other assumptions to be used, but will seek to ensure that there is reasonable certainty that the Fund will meet its targets. The contributions may rise / fall over a six year stepping period to smooth out variations. Rates will be agreed for individual employers, so that the actuary / administering authority will consider individual employer covenants in setting recovery periods. The Funding Strategy sets out how the administering authority is seeking to ensure how the deficit will be reduced over the recovery period, and will require occasional monitoring to ensure that investment returns, inflation and other assumptions are progressing in line with expectations. Again, as investment returns tend to be volatile, the monitoring can produce volatile results.

22 Awareness of the importance of monitoring and controlling early and ill health retirement costs. Prior to the Audit Commission report ‘Retiring Nature’, early retirement costs (the ‘pension strain’ costs of allowing staff to draw their benefits for longer, and pay contributions for less time) had been allowed to increase fund deficits. Brent has rules on charging employers for early retirements – payments start one year after retirement, and continue for three years. Ill health retirements are tightly constrained by regulations, and numbers have reduced sharply in recent years.

23 A broad understanding of the implications of including new employers in the fund, outsourcings and the cessation of existing employers. Including a new employer within the Fund has actuarial implications – the actuary must determine an employers’ contribution rate – administrative implications – communication, collection of contributions, changes in circumstances – and covenant implications – how strong is the employers covenant, is there a requirement for a protective bond, and what are the implications for the investment strategy. A scheduled body (one named in a schedule by the Department of Communities and Local Government), may have a stronger covenant than an admitted body (one that has simply applied for admission, such as a charity or an employer that has joined the fund following an outsourcing). If there is an outsourcing, the new employer has the duty to provide a scheme of similar value or join the Brent scheme, with all the implications of being a new employer. In particular, time horizons may require a different treatment of investment risks. If an existing employer ceases, a payment may be receivable for any deficit payments that are outstanding. If the employer has become bankrupt, any bonds that are held may be called to cover a deficit.