

**SCOTTISH PUBLIC PENSIONS AGENCY  
MINUTES OF THE EXTERNAL MANAGEMENT BOARD MEETING HELD AT  
13:30 HOURS ON 30 APRIL 2013 AT TWEEDBANK**

**In attendance:**

James Taylor	Chair
Julia Edey	Non-executive Director
Alex Smith	Non-executive Director
Eleanor Emberson	Director of Financial Strategy and Head of Revenue Scotland

Neville Mackay	SPPA Chief Executive
Eleanor Guthrie	Deputy Director of Operations
Marion Chapman	Director of Corporate Services
Chris Fenton	Director of Finance (Last Meeting)
Ian Waugh	Director of Finance (New)
Chad Dawtry	Director of Policy (First Half)
Ken Kneller	GAD (For paper 34.1)
Minutes	Liz Rae

**Apologies:** Pamela Brown

**1. Apologies and Introduction**

1.1 Mr Taylor welcomed everyone to the meeting in particular to Ian Waugh who will be replacing Chris Fenton who is retiring today.

1.2 Apologies were received from Mrs Brown. Ms Guthrie was deputising.

**2. GAD Annual Report (Paper 34.1)**

2.1 Mr Kneller introduced his paper, informing the Board that it had been a challenging and generally positive year, excepting the issue of the overstatement of pension liabilities in the STSS scheme accounts, which he will address later. The following progress had been made during the year;

- The long running review of actuarial factors had been completed
- GAD had supported SPPA in the discussions about the reforms of the five schemes for which Scottish Ministers are responsible, with varying amounts of progress on each
- The outstanding valuations for NHS, STSS, Police and Fire (with effective dates in 2008 and 2009) were ultimately abandoned on instruction from HM Treasury.

- Formal valuations are in hand with an effective date of 31 March 2012 for most public service pension schemes across the UK. These will be used to set employer contributions as usual. They will also be used to set a baseline for the cost control mechanism for the post-reform designs. HM Treasury is currently introducing material new controls over the valuation process, which will impact on the valuation process.
- IAS 19 resource accounts for NHS and STSS were concluded with the regrettable issue of the misstatement of STSS liabilities

2.2 Looking ahead, he envisaged that during 2013-14 work on pension reform will continue, with material actuarial support required for the LGPS in particular. The deadlines associated with pension reform were extremely challenging. The completion of the 2012 valuations would dominate GAD's work for most of the year.

2.3 He explained that the key issues were largely unchanged from previous years. The following issues were drawn to the Board's attention:

- Membership data for the STSS and NHS is still not ideal from a purely actuarial perspective, although the range of data improvement work undertaken by the Agency over the past few years, together with the current project on data quality and data standards, has done much to substantively address this issue. The Agency's continued focus on further improvements to data quality is consistent with the drive towards improved governance in all UK public service schemes;
- The introduction of Career Average (CARE) designs in 2015 will raise the bar for administrators. CARE designs effectively require accurate membership records to be kept throughout a member's period of membership (unlike Final Salary designs, where in practice there is some scope for the administrator to create records retrospectively at the end of a member's career); and
- the Scottish Government faces external scrutiny and challenge from all stakeholders on the demographic assumptions used for the purposes of designing reformed schemes and subsequently for scheme funding. SPPA and GAD expect such scrutiny of demographic assumptions to become the norm going forward.

2.4 Mr Kneller also asked the Board to note that the successful analysis of Scottish demographic experience may lead to increased costs and management overheads in relation to actuarial factors. To-date Scottish schemes typically adopt the same factors as the England & Wales schemes. That practice can be justified partly through an absence of evidence of material demographic differences. If detailed analyses show material demographic differences, then either the Scottish schemes would need to derive and use their own actuarial factors, or the adoption of common factors would need to be taken as a policy decision, despite the demographic evidence.

2.5 Mr Kneller also stated that there would be significant changes across the board regarding the way Scheme Governance advice was presented. He told the

Board that the reform process for public service pension schemes will require the introduction of new governance arrangements. This will affect everyone involved in the running of public sector pension schemes. There will also be material transitional challenges.

2.6 Mr Mackay responded to these points by saying that the Agency had decided some years ago that it needed to do more both to understand the role of actuarial advice in its work and to enhance the quality of the scheme data used for actuarial purposes. Substantial progress had already been made, although there was still much to do. He asked where GAD thought we were with this, relative to other public sector schemes. Mr Kneller said that we were making good progress and that Agency staff were very motivated to improve matters further. He noted that SPPA did not have the same levels of resourcing allocated to handling some of these issues as counterpart UK schemes, but in some respects it was ahead of its counterparts in tackling the agenda.

### 3. STSS Accounts GAD Error

3.1 Turning to the error in scheme liabilities contained in the 2011-12 STSS accounts, Mr Kneller sincerely apologised both for himself and on GAD's behalf for the embarrassment which their error had caused to SPPA and Scottish Ministers. He told the Board that he accepted responsibility as he had signed off the figures. He said that it would not have been possible for SPPA as an informed client to have spotted the errors, as they were embedded deep within processes which were internal to GAD. He identified the three main causal factors as follows:

1. GAD had used new software for the STSS accounts for the first time, and this had a number of teething troubles;
2. GAD would normally have sought to involve London staff in assisting with the liabilities estimates, but due to illness they were not available and so the exercise was completed in Edinburgh;
3. Not enough checks were made by the Edinburgh team, who had been operating under significant time pressures. As a result some erroneous data had been entered. For example, GMP had been counted twice and some parameterisation was wrong.

3.2 Mr Kneller explained that the figures had now been redone and their accuracy was now assured.

3.3 Mr Kneller assured the Board that there had been lessons learned from this occurrence and that the following remedial measures were now in place for the future:

- More staffing resources will be used, utilising the London team's expertise in this area;
- Enhanced checking arrangements are in place, with formalised sign off arrangements;
- There will be new access to senior actuarial input;
- An external check is being commissioned on GAD valuation systems and processes as part of the 2012 funding valuations. This will help to ensure that

these systems are working as well as possible, which will provide reassurance for the funding valuations and for all calculations which rely on them, including resource accounts calculations;

- There will be more effective planning in order to minimise time pressures.

3.4 Mr Taylor thanked Mr Kneller for his apology which had been well received by the Board. He then asked Mr Mackay for his reaction. Mr Mackay said that GAD's response had gone some way to provide the necessary assurances, but that it would be helpful if GAD could send a detailed letter explaining the causes of the error and the remedial actions in writing. Mr Kneller agreed to this. [Note: letter received 14 May].

3.5 There then followed an extensive Board discussion at which a number of issues were raised and clarifications sought. Issues raised included the extent to which the SPPA/SG might assist GAD with the planning of the various items of work being taken forward on the Agency's behalf; the extent to which the revised arrangements represented a service enhancement as opposed to simply reverting to the previous status quo; and the implications for the Agency's external and internal audit programme.

3.6 Mr Mackay spoke for the Board when he said that, notwithstanding this problem, we had a good working relationship with GAD and are looking forward to this continuing.

3.7 Following Mr Kneller's departure, the Board discussed the contractual arrangements with GAD and what the error meant in contractual terms. It was noted that Mr Mackay would be providing further advice on this point to Scottish Ministers. He also agreed to update the Board with any further developments.

**Action: Mr Mackay to update Board with any further developments regarding the actuarial error**

#### **4. Minutes of Last Meeting and Matters Arising (Paper 34.2)**

4.1 The minutes of the previous meeting on 05 February 2013 were agreed. There were no action points to be addressed.

#### **5. Audit and Risk Committee Report (Paper 34.9)**

5.1 Mr Smith reported on the discussion of the Audit and Risk Committee which had taken place on 16 April. He drew to the attention of the Board the status of risks identified as red on the risk register and other points arising from the meeting which are recorded in the minutes.

#### **6. Progress Report (including Q4 progress against Agency and Directorate Business Plan Targets) (paper 34.3)**

6.1 Mr Mackay explained that he would focus on major items of interest but invited board members to comment on any of the issues raised in his paper.

6.2 Mr Mackay then highlighted paragraph 4 of the Report asking the Board to note progress in the Pension Reform agenda which will be discussed later in the meeting. He then asked that it should be recorded that the Board and SMT attended an Away Day in April 2013 to discuss future Governance options for the Agency required as a result of the UK Government Public Service Pension Reform Act. A paper recording the outcome of that discussion will be circulated as soon as possible.

6.3 Mr Mackay note the impact that the burgeoning constitutional reform agenda was having on the Agency's core business. He noted that it was entirely appropriate for SPPA to contribute to this area of activity, but that the resource implications would have to be kept under review and supplemented if necessary.

6.4 Mrs Guthrie then informed the Board that the Strategic Data Review was progressing well and that the Project Plan had been updated to reflect the current position. The completion date of June 2013 was still achievable.

6.5 Mrs Edey asked if the sickness figures for the last 12 months shown in the HR Matrix were better or worse than the previous year. Mrs Chapman said that the figures had increased slightly, although it was hard to establish whether the increase was statistically significant.

## **7. Agency Finance Report (Paper 34.4)**

7.1 Mr Fenton reported on the GAD error, as discussed by Ken Kneller in paper 34.1. The error amounted to an over-statement of £1.8 billion in the liabilities recorded in the audited accounts, and will be corrected as an adjustment in the accounts for 2012-13. Because the accounts are not consolidated into the Scottish Government's own accounts, the error had no effect on the SG's resource out-turn. Mr Fenton explained that the Cabinet Secretary for Finance had been briefed of the fact of the error and on further action that he may wish to take, including writing to the convenors of the Scottish Parliament's Finance Committee and the Public Audit Committee.

7.2 Mr Fenton informed the Board that the NHS scheme had registered a shortfall income against budget of £4m, while the Teachers' Scheme recorded a compensating income surplus (due to GAD error). Combined, the Schemes registered a net under-spend of £89 million, or 3.4% of budget.

7.3 Mr Fenton noted that outstanding debt amounted to £1.5 million of which £513k was being recovered by instalment. He also informed the Board that the average debtor days were computed at 1188 with a target of 180 after adjustments for balances being recovered by instalments. Mr Fenton explained that this reflected two large overpayment cases recently added to the balance. The Board were also informed that the total amount written off for this Financial Year was £255k.

7.4 Mr Fenton then explained the Financial position of the Agency, analysed by expenditure, showed a recorded underspend of £181k, however costs which have not yet been invoiced would bring that down to an estimated £53k.

7.5 On early retirement costs he reported that the cost amounted to £414k which was unbudgeted but the costs had been met through recourse to the contingency fund, the rent adjustments and the additional FESG allocation of £144k.

7.6 Mr Fenton also noted the Year to Date Agency income recorded at £181k which is £39k under-budget and that the purchase of the Tweedbank Building was completed in March. The cost benefit appraisal supporting the purchase had been pulled together at very short notice with significant estates input on valuation issues from the SG Estates team.

7.7 Mr Fenton informed the Board that the software for the employers' web development has been delivered and was undergoing extensive testing by Finance. He explained that the late delivery of the software meant that the go-live date for the project has been deferred until the third quarter of this year.

7.8 Mr Fenton explained that the web based contributions system will be developed this financial year and implemented next financial year. This enhancement will allow employers to log onto the system to submit data returns automatically.

7.9 Finally Mr Fenton wanted EMB members to be aware that the International accounting standards require the future liabilities of a pension scheme to be discounted to net present value, to reflect the time value of money. In his opinion, in an unfunded scheme, the application of this concept leads to the under-statement of pension liabilities in the national accounts, and is inconsistent with the recording of other long-term liabilities, such as Treasury bonds. There is no discretion to treat the pension liabilities in an alternative manner.

7.10 Mrs Edey asked if the Treasury's Big Pension Reform Implementation Group (BigPrig) (paragraph 18) of Mr Fenton's paper) was new and if we knew when we would have clarification about the way in which the reformed schemes were to be treated as legal entities. Mr Mackay said that he would update the Board once the position was clearer.

**Action: Mr Mackay to update Board on legal status of new schemes**

## **8. Agency Business Plan 2013-14 (Paper 34.5)**

8.1 After discussion, the Board Approved the Agency Business Plan for 13/14. The Board noted the severe financial pressures on the Agency, its inability to fund all actuarial costs associated with pension reform, and the need to avoid committing to another early release programme for staff until the budgetary situation became clearer later in the year. As before, the Board endorsed the proposal that the business plan would not be crystallised until the end of Q2.

9. Pension Reform (Paper 34.6)

9.1 Mr Dawtry provided an update on progress with the pension reform negotiations in both the UK and Scotland.

9.2 Mr Dawtry reported that all UK departments had moved into a substantive pre-implementation phase and that employee contribution increases had been introduced for all affected schemes. He also informed the Board that Lords amendments to the Public Service Pensions Bill had been debated in the House of Commons and that it was expected that it would now move rapidly towards Royal Assent and enactment in May/June this year.

9.3 He explained that the NHS situation remained critical for us and recommended raising the likelihood of being able to adequately implement Policy from April 2015 from Green/Amber to Amber. Mr Dawtry also informed the Board that they had now created a tri-partite Scottish Technical Advisory Group (STAG) to take the work forward, which will meet shortly and that they now had access to the UK Group.

9.4 Mr Dawtry advised the Board that **Teachers'** negotiations were continuing against an extended deadline of June 2013. He explained that we remain at a critical stage but would currently rate this as **Green/Amber** against achieving concluded negotiations by end June and **Amber** against a deadline of being able to adequately implement policy from April 2015.

9.5 He explained that the Police and Fire negotiations were continuing with the expectation that they should conclude by June and that this was currently sitting at Amber/Red against a deadline of being able to adequately implement policy from April 2015.

9.6 Mr Dawtry went on to explain that Local Government LG negotiations had been significantly hampered by difficulties accessing scheme data and assumptions (and were now two months behind and this could increase significantly) and had been rated as Red against a deadline of concluding negotiations by June 2013; Amber/Red against a concluding negotiations by the fall back date of August 2013, and Amber/Red for being able to adequately implement policy from April 2015.

9.7 He also explained that although SPPA were not leading on it they were now fulfilling a co-ordinating and technical support role for work on long-term reforms of five **NDPB** pension schemes

9.8 Mr Mackay told the Board that Pension Reform would have big financial consequences for the Agency and it was important that the remaining uncertainties were resolved quickly.

9.9 Mr Taylor commented that there had been a huge amount of work involved in this and that it wasn't good that some of the risks associated with individual schemes were moving to red. However, he accepted that the Agency was doing all it can to mitigate the risks. In particular, scheme members should not experience any visible

deterioration in the quality of the pension administration service they receive from 2015.

9.10 Mr Taylor asked that Mr Dawtry keeps the Board informed about timelines and be provided with an update report at the next meeting.

**Action: Mr Dawtry to provide an update on pension reform progress at next meeting**

## **10. Pension Reform Programme Management (Paper 34.7)**

10.1 Mr Mackay presented his paper explaining that its purpose was to identify the range of potential projects associated with implementing Pension Reform which will have to take place between now and the end of 2017; and to consider the ways in which they might best be collectively managed as an integrated programme of related work elements. He said that at the time of drafting the Agency had identified 9 possible projects but already he thought that the number could increase as new tasks emerged. With this in mind Mr Mackay asked the Board to consider;

10.1.1 The composition of the Programme Board;

10.1.2 Its terms of reference; and

10.1.3 Its support arrangements.

10.2 Mr Mackay then talked the Board through Annex A of the paper which contained a description of all the Projects he had identified.

10.3 The Board agreed with the approach being taken but noted that the range of work to be carried out was sufficient to have a potentially significant impact on the Agency's future funding requirements. Ms Emberson suggested that the Agency should write to SG Finance as soon as possible, laying down a marker about its future costs and ensuring that these were factored into the SG's 2013 Spending Round.

**Action: Mr Mackay to write to SG Finance laying down a marker about its future costs and ensuring these were factored into the 2013 Spending Round.**

10.4 It was also agreed that in view of the importance of the Programme to the Agency's future it would be appropriate to appoint a full time Programme Manager who would attend future Senior Management Team and Board meetings. Mr Mackay will also prepare a Formal Programme Board Terms of Reference and circulate this to members of the External Management Board for further comments and discussion later in the year.

## **11. Away Day Follow – Up (Oral)**

11.1 Mr Mackay reminded Board members of the productive session they had had at the Away Day on Governance. He informed them that he would produce a paper



setting out their conclusions about the future Governance Structure for the Agency and this could form part of the agenda for the next Board meeting.

11.2 Mr Mackay proposed that they begin the process of expanding the Board at the end of this year, once the aforementioned paper had been discussed.

## **12. Review of Register of Interests**

12.1 Mr Mackay asked the NED's if they had any changes to be made to their previous register of interests. He agreed to send copies of previous forms for them to update.

## **13. Any Other Business**

13.1 EMB and SMT expressed their thanks to Chris Fenton for his invaluable assistance over the past few years and wished him a long and happy retirement.

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

14.1 The date of the next External Management Board is Tuesday 30 July 2013.

### **Action Points**

**Mr Mackay to provide an update on any further follow-up to the STSS accounts error.**

**Mr Mackay to update Board on HMT decisions on legal status of new pension schemes.**

**Mr Dawtry to provide an update on progress with pension reform at next meeting.**

**Mr Mackay to write to SG Finance laying down a marker about its future costs and ensuring these were factored into the 2013 Spending Round.**