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Please ask for: David Anthony   Our ref: PENS/

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Dear Ms Edwards,

Call for evidence on the future structure of the Local Government Pension Scheme

Please find below the response from the Wiltshire Pension Fund (WPF) in respect to the call for evidence on the future structure of the Local Government Pension Scheme (LGPS) that was approved at its Committee meeting on 19 September 2013.

Question 1 – How can the Local Government Pension Scheme best achieve a high level of accountability to local taxpayers and other interested parties – including through the availability of transparent and comparable data on costs and income - while adapting to become more efficient and to promote stronger investment performance.

The WPF believes the current LGPS structure provides a high level of accountability to local taxpayers and other stakeholders and allows funds to collaborate or share resources to become more efficient and promote stronger investment performance.

Wiltshire Council acts as the Administering Authority for the WPF. Under current legislation, the Wiltshire taxpayer is ultimately responsible for the liabilities of the WPF. WPF's view is that accountability is best served by local decision making which is aligned with the Government's Localism agenda.

Accountability is best achieved through good governance arrangements which in turn lead to well managed funds that perform better. The WPF has robust governance arrangements, confirmed through its recent Health check by professional advisers. WPF believe all the objectives outlined in the 'Call for evidence' can be achieved through the current LGPS structure if good governance arrangements are in place.

The similarity between LGPS funds allow for numerous opportunities to collaborate and the potential to share resources, advice and investment products. LGPS funds can benefit from economies of scale and the bulk purchasing power of larger schemes through collaboration frameworks and maintain the flexibilities of local discretion to deal with the specific scheme and employer bodies issue reflecting the risks to the local taxpayer.

The current LGPS Regulations and recommended practices guidance ensure, if adhered to, a high level of accountability to all its stakeholders. Business Plans and Funding Strategy

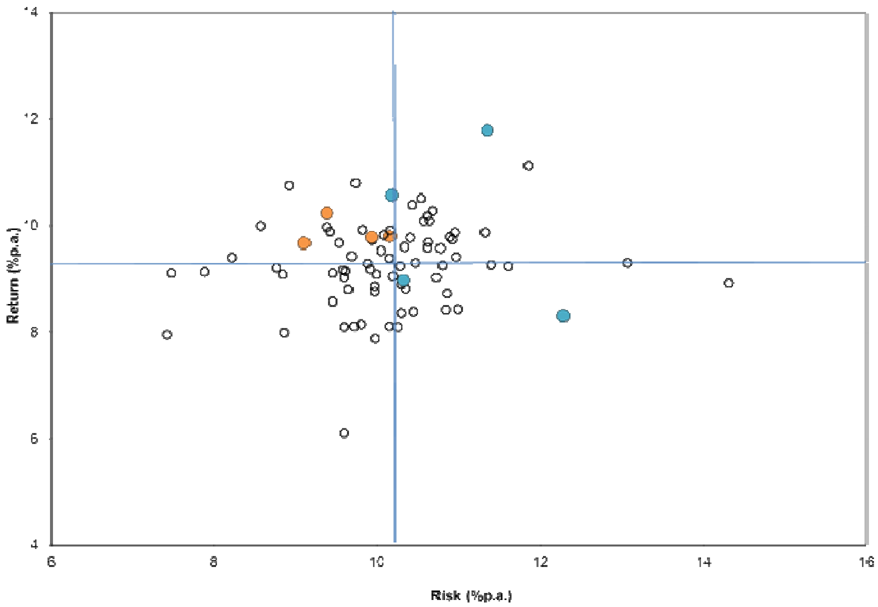
Statements outline clear and transparent fund objectives. Funds also produce comprehensive Annual Reports along with numerous other policies and statements including the Communication Policy, Statement of Investment Principles, Risk Register, Discretion Policy, Administration Strategy, Investment Strategy, Valuation Reports, Budget Monitoring, Members and officers Training Plans and Governance Compliance Statements. In addition, most Funds have excellent representation on their committee from a wide range of stakeholders including employers, member representatives and professional adviser to enable effective decision making in open or public meetings. There is also regular communication with the all scheme employers and members through seminars, clinics and newsletters.

LGPS funds also provides statutory returns to the Government, the Office of National Statistics, the Pension Regulator, the CIPFA Benchmarking club, and The WM Company investment universe. Therefore, a raft of public data is currently available on the costs, income, and performance of LGPS funds. It is agreed, comparability is difficult as this information is not collated in one central place and often not prepared on a comparable basis. This does need to become better co-ordinated with a central body either responsible for collating this information or regulation required to ensure all funds provide fully audited and comparable data in their Annual Reports.

The first priority in the 'Call for Evidence' is "Dealing with deficits". The WPF view is that merging funds will have no impact, with the potential to worsen the position through significant implementation costs. To date, WPF is not aware of any definitive evidence to suggest savings will be made in the long term. Pension liabilities forming these deficits have occurred. The only controllable aspects funds can utilise to address this is to increase employer contributions and to achieve better investment returns (net of fees).

Increasing contributions from employers is limited to their ability to pay, especially under the current financial constraints. The WPF work closely with over 127 of its employer bodies many being charities or local business that provides services to the local community, by reviewing their covenants and assessing their financial stability. This local interaction and knowledge along with an understanding of the value of the service to the local community is vital when assessing the organisation's ability to pay. Any move away from the current LGPS fund structure risks losing this vital local interaction.

The second priority is "improving investment returns". It's constantly debated whether larger funds produce better investment performance. There is much empirical evidence to support the argument either way using different extracts over varying time periods. However, the WM Company have been collating LGPS investment performance for a considerable time and are probably the best source of analysis. Their findings suggest there is no clear correlation between the size of a fund and its performance as illustrated in the chart below.



Here it can be seen from the shape of the cluster that there is no clear relationship between Funds and investment returns over the past 10 years. The yellow dots represent the four largest Funds while the blue dots show the smallest four. It can be seen that the smaller funds can perform both better or worse than the larger Funds over the long term.

Of greater interest would be the governance arrangements of the best and worst performing funds comparable to their investment performance.

Another argument is that funds could become more efficient and achieve stronger investment performance from being merged as they could achieve economies of scale to reduce both investment and administration costs. Investment management fees are a fund's most significant cost but these can differ substantially due to their specific investment strategy. Therefore a straight comparison of fees between funds cannot be made. Fees can be reduced for larger mandates but consideration also needs to be made on the quality of the managers being employed as higher fees are acceptable if it is matched by outperformance.

Similarly, the cost of administration although not as material, can differ between funds for a number of reasons. Some fund's have outsourced this function, while others have different approaches utilising shared services, while also providing a differing levels of service.

All LGPS Funds are required to submit data on their statutory SF3 returns annually. The table in the Appendix shows the figures for 2011/12. This again shows no correlation between the size of the Fund and its cost per member and there is no definitive evidence that the larger schemes have lower costs than the smaller ones.

The WPF continually strives to improve its service which is why is has been at the forefront of collaboration projects. The funds in the South West have a long history of collaborating, sharing knowledge and resources to reduce costs. This has included the setting up of a legal framework to procure and share legal costs between the funds in 2006 with delivered savings estimated to be in excess of £0.9m. More recently the Actuarial, Benefits and Investment Services Framework was established in 2011 to enable all the South West funds to procure professional advice against an agreed pricing structure. This has already delivered £400k of procurement savings across the 7 funds along with a further £150k of value added services that have been provided from providers free of charge. Although the contract is relatively new and will run for 7 years, savings have been achieved by the funds that are now using the Framework.

The South West funds have also collaborated on members and officers training, production of publication and communications material while sharing and exchanging technical knowledge when required.

This collaboration work was referenced by Lord Hutton within his final report on the review of public service pensions. He also stated in recommendation 23 that "*Central and local government should closely monitor the benefits associated with the current co-operative projects with the LGPS, with a view to encouraging the extension of this approach, if appropriate across all local authorities*".

As all funds should have common aims and providing similar services, they should be encouraged to continually explore opportunities for collaboration to improve performance. With the setting up of national frameworks collaboration is getting easier to access, while the current structure allows the ultimate decision making to remain at a local level where the impact is most felt.

Question 2 – Are the high level objectives listed above those we should be focussing on and why? If not, what objectives should be the focus of reform and why? How should success against these objectives be measured?

The WPF is supportive of the two high level objectives outlined. 'Dealing with deficits' is an important objective, but to all intents and purposes, a change in actuarial assumptions can make deficits appear reduced, as could a single strong year of investment performance, neither of which solve the long term problem.

To enable comparability between funds, these deficits need to be measured against a standard set of assumptions (e.g. those issued by the Government Actuaries Department). With comparable deficits established, employer contribution rates and deficit recovery periods can be reviewed to ensure credible recovery plans are in place.

'Improving investment returns' are vital to address deficits. However, when comparing investment performance the movement in liabilities need to be taken into account too. Investment performance should be measured against targeted returns based on individual fund's investment strategy.

The WPF believes a third high level objective should focus on governance, as arguably this has the biggest impact on a fund's performance. Governance Compliance Statements should be scrutinised by a central body and action taken where minimum standards are not being met. Arguably, poor governance is likely to lead to inconsistent deficit funding strategies and poor investment returns / strategies.

Question 3 – What options for reform would best meet the high level objectives and why?

As outlined above, the WPF doesn't believe sufficient evidence exists to conclude that larger merged funds would be better placed to meet the high level objectives. The WPF opinion is that good governance arrangements are more important than size and the implementation of the Public Services Pension Act will further strengthen these.

Although investment returns are important, there are other aspects to managing an LGPS pension fund other than management of assets. These include areas such as contribution levels, maturity of cashflows, deficit recovery plans and the credibility of funding plans. All these are reliant on good governance and effective decision making by its committee. As mentioned above, much work is undertaken at a local level working with the Fund's employers to ensure the implications of key decisions are understood by all stakeholders and that they are fully engaged.

The current structure allows funds like the WPF to retain this local decision making process but also explore areas of collaboration to become more efficient and improve investment performance.

However, the Government could assist in promoting collaboration between funds, providing assistance or helping to co-ordinate projects and frameworks at a national level. Funds with similar investments objectives should be encouraged to work together to pool investments and share procurement costs to reap the benefits from economies of scale and increased buying power while maintaining their independence.

This approach is already being developed with the establishment of local and national frameworks, shared investment mandates and the potential development of asset pooling and Common Investment Vehicles.

The Government needs to improve governance standards by challenging those who fail to meet common principles, including reporting structures and committee training. There should be closer scrutiny of training plans to ensure the correct skills are held by those responsible with managing the Fund.

The reforms that are being implemented as part of the Public Sector Pension Bill Act will help to reinforce better governance. The creation of local pension boards will provide additional scrutiny of funds decision making, while the Shadow Scheme Advisory Boards will be better placed to collate and monitor performance data. The increased role of the Pension Regulator will also assist in driving up governance standards.

As outlined in question 1, the use of frameworks and closer collaboration can provide the benefits of a larger funds while maintaining local independence.

Question 4 – To what extent would the options you have proposed under question 3 meet any or all of the secondary objectives? Are there any other secondary objectives that should be included and why?

The WPF believe the proposal outlined in question 3 can also meet all the secondary objectives.

The largest cost to a fund is the investment fees. Investment fees can differ substantially between funds due to the investment strategy being adopted. Funds can look to reduce these fees through collaboration and joint procurement to benefit from economies of scale. Through careful procurement, frameworks can be set up that allow access to all LGPS funds which reduce procurement costs and can offer significant fee reductions.

It has been suggested that smaller funds have less scope for flexibility of investment strategies. The WPF would argue this can be overcome through asset pooling and the setting up of Common Investment Vehicles. The key reform required to improve flexibility is to fully review the LGPS Investment Regulations. The limits currently placed on investments in areas like partnerships need reviewing so funds can take better advantage of opportunities.

It's arguable as to whether funds need to undertake greater investment in infrastructure. The WPF has recently made a 5% allocation to this asset class. However, each asset class needs to be considered based on the merits of its potential risk / return profile and how that fits into its investment strategy. If infrastructure projects are attractive propositions they will attract investment in their own right.

The cost effectiveness of administration can be improved through collaboration. All LGPS funds look to provide similar services. In the South West, neighbouring funds have successfully reduced administration costs with the setting up of legal, actuarial, benefits and investment advisers' frameworks. The South West Pension Officers Group have also collaborated on areas such as member training and more recently on scheme communications.

This collaboration also provides the opportunity to share knowledge, resources and in-house expertise as and when required. .

An additional secondary objective that could be included would be for the structural reforms to provide a better framework to enable greater opportunities for sharing of resources for the reasons outlined above.

Question 5 – What data is required in order to better assess the current position of the Local Government Pension Scheme, the individual Scheme fund authorities and the options proposed under this call for evidence? How could such data be best produced, collated and analysed?

As outlined above, data on governance structures, funding deficits, funding plans, investment strategies and performance should be available, presented on a common basis and either collated centrally of presented on a prescribed and audited format within each fund's annual report. This should enable stakeholders to compare performance against the high level objectives discussed.

Information on other areas such as pension administration should be collated to provide a useful benchmark to measure against. However, the allocation of costs payable to the pension fund differs between authorities so to make this meaningful clear definitions are required and the data submitted needs to be auditable. The WPF is a member of the CIPFA benchmarking club that measures pension administration costs and activities and although a basis for comparison can suffer from the issues highlighted above.

All this requires better co-ordination from a central body. The newly formed Shadow Scheme Advisory Board could best place to co-ordinate this in the future.

Having comparable data readily available could enable stakeholders to more easily identify those better performing funds and enable peers to challenge their processes and methods to ensure more effective performance.

Conclusions

The WPF believes there is no clear solution that will tackle the high level objectives outlined, but steps have already being taken to increase collaboration and sharing of resources between LGPS funds. This has proven that there is a way forward to achieve improved performance which negates the need for major structural reform.

What is now required is comparability of funds to establish those who are failing to deliver the expected standards and to allow the others the freedom to continue to collaborate where applicable to provide improved services.

Yours sincerely,

David Anthony
Head of Pensions