

WILTSHIRE COUNCIL

WILTSHIRE PENSION FUND COMMITTEE
5 June 2014

LOCAL GOVERNMENT PENSION SCHEME (LGPS): OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES CONSULTATION

Purpose of the Report

1. This report introduces the latest consultation issued on 1 May 2014 from the Department of Communities and Local Government (CLG) to inform discussion at this meeting and enable a formal response from the Wiltshire Pension Fund to be finalised.

Background

2. This consultation follows on from the Government's response to the 'Call for Evidence' issued last year on the future structure of the local government pension scheme.

Call for Evidence on LGPS structural reforms

3. The Government published on 1 May 2014 their response on LGPS structural reforms which looked at the possibility of moving away from the current 89 separate funds in order to improve performance, reduce pension deficits and costs to assist in the long term sustainability of the LGPS. They have also issued a new consultation on "Opportunities for collaboration, cost savings and efficiencies".
4. In the Government's response to the evidence submitted as part of the Call for Evidence consultation last year, they acknowledged the local accountability issues, moving away from mergers, instead recommending that Common Investment Vehicles (CIVs) are used for fund investments with asset allocation decisions retained at a local level.
5. Their evidence was inconclusive as to whether larger funds obtain better investment returns, however it appears clear there are economies of scale and cost savings, in particular on investment fees. They stepped back from looking at potential administrative efficiencies due to the risk associated with merging and will allow the new LGPS 2014 scheme to mature before considering further reform.
6. The research commissioned by the Government (from Hymans Robertson) indicate that investment fees could be significantly reduced if all listed assets were passively managed, as on aggregate across all LGPS funds they produce the same returns after fees as more expensive active management.
7. Therefore, the Government propose all listed assets are passively managed (again through a CIV to benefit from scale) and that only alternatives (i.e. property, infrastructure, hedge funds, etc.) are actively managed, but again done through a CIV to reduce fees.
8. The Government's full response can be viewed at:
<https://www.gov.uk/government/consultations/call-for-evidence-on-the-future-structure-of-the-local-government-pension-scheme>

Considerations for the Committee

Government Consultation: Opportunities for collaboration, cost savings and efficiencies

9. The current Government consultation is attached in the Appendix. Based on the cost benefit analysis the Government commissioned from Hymans Robertson they have made a number of assumptions. In summary, the Government believe savings of £660m p.a. can be achieved by reforms to the LGPS by:
 - a) Moving to passive fund management of all listed assets accessed through a CIV (£420m)
 - b) Ending the use of “fund of funds” arrangements in favour of a CIV for alternative assets (£240m)
10. The Government believe the use of CIVs enable significant savings to be implemented quickly. A further decision is whether these CIVs should operate at a national or regional level, and whether their use should be mandatory.
11. The proposal to move all listed assets to a passive basis is a significant step, but the research they relied upon reflects that on aggregate performance would be unaffected while costs would reduce. The common view is that asset allocation is the most significant influence on investment returns and the Government is proposing this is still carried out at a local pension fund committee level.
12. Also, it is argued that if made mandatory, the use of CIVs could make comparability in investment performance easier as investment costs would be uniform; enabling poorer performing funds to be identified through their asset allocation decisions and governance arrangements.
13. The detailed 104 page LGPS structure analysis by Hymans Robertson can be found at the following link: <https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>
14. The consultation requests responses to the following questions by 11 July 2014:
 - Q1.** *Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.*
 - Q2.** *Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?*
 - Q3.** *How many common investment vehicles should be established and which asset class's do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?*
 - Q4.** *What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?*
 - Q5.** *In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?*

- a) *Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.*
- b) *Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.*
- c) *Fund authorities could be required to manage listed assets passively on a “comply or explain” basis.*
- d) *Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report*

Overview

15. This proposal to move forward with the use of CIVs, and step away from fund mergers at this stage is a major change but whether the assumed cost savings and improved investment performance can be achieved is the big question. Much will depend on what types of CIVs are set up, how many there are, and how they are governed. This is a complex area and more information and research is required at this stage.
16. The decision to retain local asset allocation arguably assists with maintaining local accountability and feels like a sensible approach.
17. The most contentious issue is the use of passive investment for all listed stock and how this may impact on fund performance. By rejecting all active management for listed assets, is the Fund limiting its ability to outperform the market and ultimately its ability to close its funding gap? Or over the long term does passive management produce the same outcome? The Wiltshire Pension Fund has a 30% strategic allocation to passive management so arguably has already embraced this strategy, but is there a need to go further?
18. The arguments for alternative assets within a CIV may be more attractive due to the obvious economies of scale and high associated fees which are more difficult to access at a smaller level.
19. However, further research needs to be undertaken before finalising a response. Therefore, a proposed draft response will be discussed at this meeting and it is proposed the Committee delegate approval for the final response to the Chairman and Vice Chairman to ensure the 11 July 2014 deadline is met.

Risks Assessment

20. The proposed response does not directly impact on any risks for the Wiltshire Pension Fund.

Environmental Impact of the Proposal

21. There is no known environmental impact of this proposal.

Safeguarding Considerations/Public Health Implications/Equalities Impact

22. There are no known implications at this time.

Financial Implications

23. The financial implications are considered as part of this paper but have no immediate impact for the Fund.

Reason for Proposals

24. The Fund should be proactive in shaping the future of the scheme and therefore should contribute to the consultations issued.

Proposals

25. Members are recommended to delegate the approval of the formal response to the consultation to the Chairman and Vice Chairman taking into considerations the points raised at this meeting.

MICHAEL HUDSON
Treasurer to the Pension Fund

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Unpublished documents relied upon in the production of this report: