Agenda Item:

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Pension Fund Committee

Dorset County Council

Date of Meeting	26 June 2014
Officer	Pension Fund Administrator
Subject of Report	**Consultation on future structure of the LGPS**
Executive Summary	The Department for Communities and Local Government issued a call for evidence on the future structure of the Local Government Pension Scheme (LGPS), which ran from 21 June to 27 September 2013. 133 responses were made, and in addition to these submissions the government commissioned some additional analysis and Hymans Robertson were appointed to undertake this piece of research. Having considered the responses to the call for evidence as well as the Shadow Board's recommendations and the Hymans Robertson report, the government issued, on 1 May 2014, a consultation around a package of proposals. These proposals aim to "balance the opportunities from aggregation and scale whilst maintaining local accountability". The consultation list the package of proposals as: - Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs - Significantly reducing investment fees and other costs of investing by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market - Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme.

	- A proposal not to pursue fund mergers at this time. A full version of the consultation will be available at the meeting, and can also be found on the government's website www.gov.uk on the consultations pages. The deadline for responding to the consultation is 11 July 2014, and attached as appendix to this report is a draft response on behalf of the Dorset Fund. The draft response is broadly supportive of the recommendations within the consultation; the decision not to pursue forced mergers at this time, and the acknowledgement of the importance of local accountability are examples of this. The proposals around the creation of common investment vehicles (CIVs) to make better use of economies of scale is a broadly sensible approach, although the government would need to allow enough time to setup each CIV to ensure that they were effective. The final proposal to actively encourage the use of passive management in listed assets is also reasonably sensible, and the Dorset Fund does, indeed, make good use of passive management. There are a number of potential options in this area, and we would be supportive of the option requiring funds to manage listed assets passively on a "comply of explain" basis. The option to require funds to move all listed assets into passive management would, however, not be one which the Dorset Fund would support. Members are asked to comment on the attached draft in advance of the deadline for issuing a response.
Impact Assessment: *Please refer to the protocol for writing reports.*	Equalities Impact Assessment: N/A
	Use of Evidence: N/A
	Budget: N/A
	Risk Assessment: Low
	Other Implications: None

Recommendation	That members consider and comment on the attached draft response to the consultation ahead of the deadline to respond of 11 July 2014
Reason for Recommendation	To ensure that the views of the Dorset Fund are expressed in formulating the future structure of the LGPS
Appendices	1. Draft response to the consultation – LGPS: opportunities for collaboration, cost savings and efficiencies.
Background Papers	DCLG consultation papers
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Date: 30 August 2013
Your ref:
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Dear Victoria

LGPS: Opportunities for collaboration, cost savings and efficiencies

Dorset County Council welcomes the opportunity to respond to the consultation the future of the Local Government Pension Scheme.

In principle, we are broadly supportive of the proposals that will enable the LGPS to remain affordable for employers, and sustainable in the long term. We are also pleased that the government has reacted positively to the recommendations of the Shadow Board.

We are pleased that the proposals contained within the consultation do not include forced fund mergers at this time. We are still of the view that forced mergers would be very expensive to implement, and would remove any local accountability that is currently within the LGPS. We are pleased that the government has recognised that retaining this local accountability, both in terms of the links to directly elected councillors and the participation of local employers is important.

We believe that in principle the proposals around use of Collective Investment Vehicles (CIVs) and greater use of passive management are likely to achieve some level of saving, although remain sceptical of the overall levels of saving being quoted.

Our response to the questions in the consultation are as follows:

Q1 – Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments?

We believe that, in theory, the use of CIVs offer all stakeholders the potential to achieve economies of scale. The work that is currently being undertaken in London to setup and manage a CIV on behalf of the London Boroughs should be studied closely and used as a case-study to enable the government to learn lessons from the process that has been followed. We also believe that the government needs to ensure that the appropriate level of time and resource is allowed to ensure that these complex vehicles are setup properly. If these significant changes to the way in which the LGPS assets are managed is rushed, there is the possibility that the CIVs could end up as very expensive “white elephants” that are of no practical use to anyone.

There are asset classes in which CIVs will work more effectively than other, listed equity, for example, could offer a good starting point for the introduction of CIVs. The assets are very liquid and could be moved into a collaborative vehicle fairly quickly and efficiently. However, the level of saving that could be achieved in listed equity may not be as significant as some of the more esoteric alternative assets.

We agree with the Hymans Robertson research that shows that accessing alternative assets through expensive fund of fund arrangements is an area which could benefit significantly from a more collaborative approach. It does, however, need to be recognised that these assets, such as Private Equity or Infrastructure are likely to be very illiquid, and therefore transferring existing assets into a CIV could take a number of years. It is also an area where funds access niche, less mainstream investments which may have limited capacity, and would not be suitable to form part of a CIV.

Q2 – Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

Yes. Funds will have different liability profiles and therefore different investment strategies to address these liabilities, and reflect their attitude to risk. Whilst a CIV will potentially reduce managers' fees and transaction costs and therefore potentially improve returns, asset allocation decisions will always have the greatest influence on returns. Keeping asset allocation decisions a local discretion will ensure that funds do not take more risk than is necessary for their own position. It will also ensure that the link to the local tax payer is maintained.

Q3 – How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed and alternative asset common investment vehicles?

The establishment of the London LGPS CIV (Authorised Contractual Scheme – ACS) has a number of key guiding principles, and we believe that the wider LGPS CIVs that are being proposed in this consultation should also follow a similar set of principles. The London principles were:

- Investment in the ACS should be voluntary. A borough should be able to decided they do not wish to participate, or to the extent they initially decided to participate, to choose to withdraw their investment.

- If a borough chose to invest, it will be able to choose which asset classes to invest into, and how much they might in invest into each asset class.

- The boroughs should have sufficient control over the ACS operator, in order to be assured that it will be acting in their best interests.

- The ACS operator would provide regular information to participating boroughs regarding the performance of managers, investment options, and other areas so that information continues to be available to the sane extent it is currently in order for boroughs to make investment decisions.

- Authorities seeking to invest in the ACS will also take a shareholding interest in the operator (and have a membership of the Pensions Join Committee).

- The ACS will not increase the overall investment risk faced by boroughs.

We believe that these principles are key to the operation of the London CIV, and would like to see similar principles being operated in the national LGPS CIVs. There are several areas in which operating a CIV in London is potentially easier than doing so nationwide. For example, the establishment of the London CIV a Pensions sectoral Joint Committee has been created, but the existence of the London Councils to administer this has been essential. We are not aware of other such bodies that could serve this purpose nationally.

To answer the specific question around the number of CIVs is a difficult one, but agree that it would be desirable to keep the number of vehicles to a minimum due to the expense of setting up and managing them. The potential risk of minimising the number of CIVs could be significant, should all funds end up investing with one manager, the risk of having all the LGPS “eggs in one basket” would increase risk across the scheme.

The question of which asset classes should be included, would really depend on how each CIV was operated, and how liquid the investments contained within them were. Listed passive equity would be the simplest area to start with, but we are not convinced that this would make significant levels of saving, as passive equity is a very much a commoditized product, and fee levels of 3-4 basis points or less are not unusual in the larger well managed funds.

Q4 – What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

Earlier in this response, we have referred to the arrangements currently being put in place by the London CIV. We believe that a similar setup would be a sensible approach for national CIVs, however as previously mentioned London does benefit from the existence of the London councils, and how this operated within the wider LGPS where such structures are not in place, remains to be seen.

The decision of which type of vehicles to use will be key. The London boroughs have selected an Authorised Contractual Scheme (ACS), but there are a number of ways to pool investments, and each have different characteristics and offer the investors different levels of tax transparency. The government will need to ensure that the vehicle that is selected is the most appropriate for Local Government investments.

We also previously referred to the need to ensure that the appropriate amount of time and resource is given to establishing these vehicles. If such a significant change to the way in which the LGPS invests is rushed through to meet other external deadlines, the risk of failure is high. Instead of realising the level of savings which are hoped for, the CIVs could end up costing more in terms of time and money.

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 the best value to taxpayers, scheme members and employers?

The Dorset Fund believe that to require funds to move all listed assets into passive management is too restrictive, and some would say goes against the principle of keeping asset allocation decisions local. It could be viewed that a decision to invest passively or actively is an asset allocation decision, and is dependent on the risk parameters of the individual funds. Whilst the Hymans Robertson evidence suggests that this may not have a detrimental effect on the performance of the LGPS in aggregate, it would fetter the discretion of funds to seek higher performance from active management if their liability profile required it. There is plenty of evidence to show that active management can be very successful in achieving alpha as part of a diversified portfolio, and it would be wrong in our view to block this option.

We believe that the best value for taxpayers, scheme members and employers is to allow fund authorities to continue taking decision on passive investment locally, and would support the “comply or explain” option. This option offers funds the option to continue to investment actively where appropriate, but only if they have demonstrated that they have taken appropriate advice, and that they understand why they are doing so. In our view, this could mean that some of the smaller, less well managed funds may be forced down the route of passive investing, if they cannot explain why they want to invest actively.

Additional considerations

Data transparency – We would support the work that the Shadow Board is doing in compiling a central repository of information on LGPS Funds. The Dorset Fund firmly believes that LGPS fund are very transparent, and that they publish significant amounts of information about their operations. The one thing that is missing in a lot of areas is any analysis of this information, and in some areas, a lack of consistent advice of how to report on certain aspects of fund management. A clear example of this is the accounting for fund management fees; there are a number of different ways that funds can account for the fees that are spent on fund management. If a fund has a segregated account with and investment manager, and that manager is paid on an invoice, then the fund needs to show that figure in their accounts. However, if a fund invests into a pooled fund, and the investment management fees are deducted from the value of the units, the fund does not have to show this figure in the accounts. This is only a minor point, but when comparisons are made between funds can lead to very different answers.

Procurement frameworks – The Dorset Fund has been involved in work on a number of frameworks in the South West, and has recently been involved in the establishment of a National framework contract for legal services. We are firm believers that they offer significant savings in the procurement process, as well as fee savings, and would support their wider use. We would even go so far as to suggest operating a “comply or explain” regime in this area; if a framework contract exists for a service that a fund needs, we believe that they should use it.

Administration – We support the view that savings in fund administration are small when compared to other potential efficiencies that are available elsewhere. The Dorset Fund also supports the view that looking to change administration arrangements so soon after implementing the 2014 scheme would not be sensible. The involvement of The Pensions Regulator with effect from 1 April 2015, may well highlight areas of administration that could be made more efficient and effective. The Pensions Regulator could give the government its assessment of those areas once they have assessed the position.

Yours sincerely

Nick Buckland
Head of Treasury and Pensions