Committee(s):	Date(s):
Finance Committee	23rd September 2013
Subject: Local Government Pension Scheme (LGPS) 2014 Implementation	**Public**
Report of: Chamberlain	**For Information**

Summary

In March 2011, the Independent Public Service Pensions Commission, chaired by Lord Hutton, published its final report of the review of public service pensions. The report made clear that change is needed to “make public service pension schemes simpler and more transparent, fairer to those on low and moderate earnings”.

Subsequently, following discussions between the Government and the Trades Union Congress and submissions from the Local Government Association it was decided that the Local Government Pension Scheme (LGPS) should be reformed and that the effective date for such reform should be 1st April 2014.

This report relates to a call for evidence on structural options, and suggests a response. In essence the Committee is asked to agree the London Councils’ view that change is necessary and support the work is happening across the boroughs to potentially move towards the pooling of certain pension fund assets and mandates for which there is already a large measure of willingness.

Recommendation

Members are asked to note the report and agree it as the basis on which to submit a response.

Main Report

Background

1. I reported to the last meeting of the Finance Committee on the ongoing development of the proposed LGPS 2014 and our plans to implement the new scheme for April 2014.

2. I mentioned in that report that the DCLG and the LGA have also issued a joint call for evidence into ways to increase cooperation between LGPS funds which could affect the future structure of the LGPS. The call for evidence is appended and it should be noted that the closing date for submissions is 27 September 2013.

3. In summary, the call for evidence follows a roundtable event which discussed the possibility of structural change to the current 89 funds. The Local Government Minister has stated that there is a need to improve investment performance and reduce fund management costs and that although there is no pre-determined solution to what is a complex and contentious issue he is not wedded to the existing number of 89 funds in England and Wales and if it takes a smaller number of funds to improve the efficiency and cost-effectiveness of the scheme, he shall not shy away from pursuing that goal.

4. In London, the London Pensions Fund Authority (LPFA) has been arguing for the merger of finds into a single fund, or a “superpool”; London Councils meanwhile is looking at alternative ways of collaboration, particularly through establishing a Collective Investment Vehicle (CIV) or, more recently, an Authorised Contractual Scheme (ACS).
5. A CIV is a vehicle in the United Kingdom, established under a trust deed, to allow the pooling of assets or part of assets of different regulated pension schemes for investment and record keeping purposes. The CIV maintains the ability to distinguish the asset and income values attributable to each participating plan. The shares in the pooled funds attributable to each pension scheme are established on a unitised basis. There is no requirement that all of the assets of a scheme must be included in the CIV.
6. An ACS is a Tax Transparent fund which provides a new opportunity and particular benefits for pension funds looking to group together and pool their assets. An ACS can adopt one of two forms – either a co-ownership structure or a limited partnership structure. Whilst legal title to the assets of the ACS is vested in the depositary, the beneficial interest is held by investors as tenants in common or as common property.
7. A report will be submitted to London Councils in October setting out the relative merits of the CIV and the ACS. Both offer advantages in the form of economies of scale and access to investment opportunities that might otherwise not be available. However a particular attraction of the ACS is that it has been designed specifically to support the joint investment/ pooling of pension fund assets in the most efficient manner and has the full support of both HM revenue and Customs and HM Treasury; this is therefore likely to be the recommended option.
8. When this issue was briefly discussed at a previous meeting of the Financial Investments Board, members agreed that the City Corporation should support further work on a collective approach and that work is indeed continuing.

The Call for Evidence – suggested City Corporation response

9. The Call sets five questions each of which is considered further.

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.

10. There is already a high level of local accountability for the scheme. Each administering authority is required to prepare a separate set of accounts, which is audited separately, and these are fully accessible to local taxpayers and other interested parties. So this really should not be an issue.

11. What perhaps may be more of an issue is in comparing the information. For example whilst comparative data is produced on investment performance on an annual basis by the WM Company, and is again publicly available, this does not form part of a local authority's own reporting requirements. Neither is it the case that an administering authority has to produce an annual report – some (like the City Corporation) choose not to, although the majority do so. Also many pension funds will have an annual meeting when the report is presented to members – and there is no reason why such meetings should not also be open to the public. Neither does the DCLG produce an annual report of itself, although there is an obvious locus.

12. It seems therefore that arrangements could be improved if:

    - There is a requirement for an annual report to be produced and an open meeting for it to be discussed; and
    - The DCLG should itself produce an annual report, covering all pension funds, setting out, inter alia, the investment approach and returns both net and gross of investment fees and administration costs.

Question 2 – Are the high level objectives listed (on the Appendix) 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?

13. In previous discussions on the LGPS, members have stated that a prime objective should be to maintain membership levels and connected with this, affordability is the key issue. This seems to be a singular omission. This can be measured relatively easily through the level of employer contributions and the membership of the scheme by the workforce.

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

14. The objectives of dealing with deficits, improving investment returns and maintaining membership levels are all hallmarks of a healthy fund. It is recommended that the City Corporation should endorse the London Councils work on this issue and on how the London Boroughs can work together and collectively through establishing a CIV or an ACS.

15. In summary, the London Councils' view is that:

- change is necessary and work is happening across the boroughs to potentially move towards a collective approach for which there is already a large measure of willingness; and
- the collective approach presents an opportunity to deliver on efficiency and value for money, but without the need for time consuming legislation or expensive mergers.

16. London Councils' work commenced long before this consultation process and he Leaders' Committee has received papers on three occasions leading to its May 2013 meeting, at which it was agreed in principle to move towards a CIV for those boroughs who wish to, subject to Leaders' Committee consideration of the outcome of the further work by the Working Group. Along with the Director of Finance from Wandsworth, I am an advisor to the Working Group.

17. Since May, a sub-group under the Chairmanship of the Director of Finance from Wandsworth, and made up of pension investment officers from Barking, Bexley, Croydon, Ealing, Hackney, Newham and Wandsworth, have met to investigate options on the above issues. As mentioned earlier, now the ACS has been launched, this provides another option for a collective approach.

18. It is anticipated that papers will go to the October Executive and November Leaders' Committee meeting for members to take final decisions on whether to proceed to implementation or not. In the meantime virtually all London boroughs have signed up in principle, and none have objected.

19. Initial estimates are that for £4 billion of funds under management (under 20% of Borough LGPS funds) the likely annual cost of a CIV will be in the region of 5Bps (£2m p.a), which will reduce in relative terms with more funds under management.

20. These costs would be more than covered by savings in fund managers' fee reductions from economies of scale in their charging schedules, improving net investment returns and reducing the cost of membership. Additional investment performance should also be expected from the availability of best in class investment managers.

21. Boroughs would also be able to save administration costs, particularly procurement and investment advice costs of between £20,000 to £30,000 each time a mandate is tendered and be able to move more quickly when a manager underperforms.

22. Initiation and other costs should be acceptable. Based on the current number of boroughs who have already expressed an interest, the estimated subscription to cover these costs would not exceed £20,000 per subscribing borough.

Key Benefits and outcomes from a collective approach

23. The basic flaw in the assumptions on merging pension funds into larger pools is that larger funds will deliver better investment returns and lower costs than smaller funds. This is not our own experience as is evidenced in an analysis undertaken by PwC for the Society of London Treasurers - Appendix B. The City's investment returns are significantly higher than the average of larger funds over the last 3 and 5 years and this outperformance will increase when the latest figures are included. The lower costs that would be gained are a fraction of the investment returns. The CIV approach achieves the lower costs and allows the asset allocation decisions to be made locally – which maintain the performance outcomes funds are currently achieving.

24. There are no legal obstacles: legal advice is that no primary legislation is needed. There may need to be some minor changes to Regulations.

25. Implementation can be relatively swift: Following Leaders' approval implementation could take up to nine months to conclude, leaving summer 2014 as a potential start date. Already two boroughs (including the City Corporation) have expressed an interest in acting as lead authority, should this prove necessary.

26. Implementation can build on existing governance structures, through London Councils and will have a best of industry standard in terms of skilled trustees

27. In summary then, the important factors in favour of a collective approach through a CIV or an ACS:

- Achieves similar financial gains to a merger, but without the disadvantages and loss of governance as key decisions on asset allocation will continue to be made locally. This is essential as asset allocation differences between boroughs will reflect their different funding levels, cash flow positions and risk appetite. A single fund removes this choice.
- The pace of change can be decided to suit individual authorities, support a consensual approach and can operate for only part of a borough's pension fund assets; each borough would decide what proportion of their funds to put through the CIV or ACS;
- Relatively easy to implement versus considerable upheaval and costs that could accompany merger route and therefore provides quicker and easier access to asset classes such as infrastructure or housing for smaller funds, bringing down the costs of entry to such assets and enabling greater investment flows into these assets (meeting one of the government's objectives to see pension investments into infrastructure);
- Cost savings on the procurement process and on investment management fees – benefits of scale and an enhanced ability to influence managers on wider issues not just fees such as corporate governance and social responsibility
- Potential for performance enhancements by ability to switch to best in class – this could add significantly to investment returns for funds participating; and enhanced resources to investigate new investment opportunities, giving funds

access to new assets/investments at an earlier stage; the ability to offer borough funds access to liability management techniques (hedging of inflation and/or interest rate risks for the duration of liabilities);

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?

28. It is suggested that all of the secondary objectives would be met through this option.

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?

29. Each pension fund is independently valued by their actuary and there is no reason why this should not continue. However, in order to measure the relative position of funds accurately and consistently, it would be worthwhile to also apply a common set of actuarial assumptions. These variables could be provided by an appropriate body such as the Government Actuary's Department. The expected returns from different asset classes and discount rates vary markedly across the LGPS and there may be good reasons for this. But it is important to identify and understand differences and, to provide a total picture and to facilitate this the method of measuring in this analysis should be consistent across all funds

Conclusion

30. The call for evidence on structural options does make the case for change and the Committee is asked to agree to this and support the work is happening across the boroughs to potentially move towards a collective approach rather than through forced mergers which seems to be the other option

31. If the Committee agrees to this approach, it is unlikely to be alone. The Welsh Councils have already publicly endorsed this line; and informal discussions with other interested parties indicate a high level of support.

Appendices

- Appendix A – The Call for Evidence
- Appendix B – Reconfiguring the London LGPS funds : PwC analysis

Background Papers:

- Report to Establishment and Finance Committees May 2011: Consultation on the report of the Independent Public Services Pensions Commission Final Report.

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