<table>
<tr><td colspan="3">Bath & North East Somerset Council</td></tr>
<tr><td>MEETING:</td><td colspan="2">AVON PENSION FUND COMMITTEE</td></tr>
<tr><td>MEETING DATE:</td><td>13 December 2013</td><td>AGENDA ITEM NUMBER</td></tr>
<tr><td>TITLE:</td><td colspan="2">UPDATE on LGPS 2014 & CALL FOR EVIDENCE</td></tr>
<tr><td>WARD:</td><td colspan="2">ALL</td></tr>
<tr><td colspan="3">AN OPEN PUBLIC ITEM</td></tr>
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Appendix 1 – LGPS 2014 – [Changes to Benefits]
[Transitional] Protections and Councillors [TBC]</td></tr>
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1 THE ISSUE

1.1 The purpose of this report is to present to Committee an update of current events concerning the new Local Government Pension Scheme 2014 [LGPS 2014], All consultations on draft regulations have been reported at previous committees.

1.2 Actual Regulations outlining the benefit structure going forward were released on 20 September 2013.The transitional regulations dealing with protections for the current scheme benefits and also including the future of Elected Member's participation within the scheme were expected before the end of November 2013 but DCLG have recently indicated a revised date around mid-December. The implementation date for the new scheme is 1 April 2014.

1.3 As reported at the September Committee, there has been a delay in the production of the actual regulations which has restricted the period required for both administering authority and scheme employers to prepare processes and communications.

1.4 At the meeting officers will give a verbal update on any late developments on LGPS 2014.

1.5 There has been much analysis and debate surrounding the administration and investments costs of LGPS funds, especially on the variance in cost base between individual funds following the Call for Evidence earlier this year. Section 6 updates the Committee on the latest analysis and debate on this issue.

2 RECOMMENDATION

That the Committee:

2.1 Notes the current position regarding the changes to the LGPS in 2014.

2.2 Notes the information on administration and investment costs.

3 FINANCIAL IMPLICATIONS

3.1 The administrative and management costs incurred by Avon Pension Fund are recovered from the employing bodies through the employer's contribution rates

3.2 There are no specific financial implications.

4 LGPS 2014: Regulations issued

4.1 It was intended that the actual regulations would have been available in the Spring of this year. However as a result of various consultations and incorporating the effects of the Public Sector pensions Act 2013, there has been a delay in producing the actual amending regulations.

4.2 The actual amendment regulations setting out the new scheme details going forward from 1 April 2014 were finally issued on 20 September 2013. The main changes going forward are set out in Appendix 1.

4.3 The Transitional regulations dealing with accrued benefits from previous legislation up to 31 March 2014 were expected to be out by the end of November 2013 but have been further delayed until sometime around the date of this committee. There are a number of issues including Elected Member membership that needs to be sent to Ministers before it can be laid in Parliament. If these regulations are laid before the meeting, details will be outlined in with the verbal update.

5 LGPS 2014: Other Developments

5.1 As a result of the new scheme coming into effect the production of Annual Benefit Statements for 2014 will not require a projection to retirement age as at the statement date there will be no potential future benefits under the current regulations at that point.

5.2 Currently there is a requirement to send out Annual benefit statements by the end of September. The new scheme has brought forward this requirement so that the statements from 2015 onwards are issued before the end of August.

5.3 The Pension section is working in various ways with local and national groups to achieve several administering and communication solutions.

6 LGPS Investment Costs

6.1 The significant area of focus within the recent Call for Evidence on the future structure of the LGPS was on investment management costs of LGPS funds. The LGPS has £167bn assets in total, and has annual investment management costs of £506m, i.e. costs of 30p for every £100 managed (based on published data).

6.2 There has been a lot of analysis and debate surrounding this issue, especially on the variance in cost base between individual LGPS funds. The paper from the Centre for Policy Studies "The LGPS: Opportunity Knocks" (November 2013) is the latest such analysis on the state of the LGPS. Much of the analysis (including that of the Centre for Policy Studies) is based upon the only data available across all LGPS funds: that supplied by funds in their annual returns to DCLG (SF3 returns) and in Annual Reports produced by individual funds. There are several shortcomings of the research based on these data sets:

a) The SF3 data reports only costs and fund size and therefore any conclusions drawn on the comparative cost of individual funds do not reflect any other factors that have significant implications for variance in costs. These include factors such as what asset classes the fund is invested in, and the implementation structure (mandates) of those investments - for example a fund that invests in listed equities on an internally managed passive basis will incur significantly lower costs than the same size fund that is invested in externally managed active private equity.

b) Data reported by individual LGPS funds in their annual reports is not always reported on a comparable basis - for example some LGPS funds include the fees paid on pooled funds in their accounts as investment management fees, whereas others simply include net returns on investments, which means that fees on pooled funds are omitted from the fee analysis in those cases (for most pooled funds, the fees are deducted from the fund value and are not invoiced directly to investors).

c) Neither seeks to evaluate the added value i.e. the net impact upon returns after fees, they only focus on monetary costs.

d) Neither do the costs reflect transitioning as funds adjust their investment strategy to global economic conditions to better manage risk, moving between asset classes and investment managers. As the strategies to manage risk and volatility are often more complex (e.g. inflation and interest rate hedging, illiquid & uncorrelated assets such as infrastructure) the fees are often higher than the traditional mandates. In addition, these are often implemented using overlay strategies (do not alter the underlying portfolio of assets) which add to the overall fees.

6.3 One of the objectives of the Shadow National Advisory Board is to produce consistent disclosure of all costs (administration and investments) incurred by Funds which will address some of the shortcomings of current published data.

6.4 Recently a number of the Fund’s managers have reduced fees in the light of increased competition and pressure on fees. The market is also starting to see managers offering specific fee discounts to LGPS funds by offering specific LGPS share classes.

Investment Cost Benchmarking Study

6.5 The Fund has participated in a benchmarking study carried out by CEM Benchmarking. The study aims to benchmark costs of LGPS funds with their peers and with private pension funds globally. The study analysed a universe of 355 pension funds globally, ranging in size from £27million to £408 billion. The median size was £2.9bn a very similar size to APF.

6.6 This study is probably the most comprehensive attempt to date to compare investment related costs on something approaching a comparable basis. The study requested detailed costs and fees on all individual investment mandates and undertook due diligence with funds so that disclosures were consistent. They used default fees in only 2 areas - for underlying funds in fund of hedge fund portfolios and real estate. They also omitted performance fees on private assets as the reporting is very complex and dependent on the stage of the investments. The study analysed the results for the 2012 calendar year only.

6.7 Key highlights from the study with reference to the Avon Pension Fund are as follows:

a) Value added measures the value above that generated if the Fund was invested on a passive basis and so evaluates the contribution of active management after costs. **APF's added value was +1% compared to the global median of +0.5%.** This analysis is supported by the Fund's own performance data which shows the value added by active managers was the major contributor to outperformance of the strategy over each of the last 3 years.

b) Total investment cost includes asset management costs, oversight, custody and other costs, but excludes transaction costs, private asset performance fees and actuarial fees. APF total investment cost was 47.2 basis points (bps), marginally below the global median of 48.6 bps.

6.8 The benchmarking exercise created a 'benchmark fund' for APF based on funds of a similar size and asset mix but not taking into account the method of implementation. Analysis showed the benchmark fund cost of 55.3bps, 8.1bps higher than actual APF costs. The difference between the fund and benchmark result from:

a) extent to which the fund uses a higher cost or lower cost implementation 'style' (internally managed portfolios are generally less expensive than externally managed, and passive management is less expensive than active management)

b) whether paying more or less for asset management, oversight and custody compared to similar sized funds with similar style and asset mix. Obviously there can be many variables that affect this including the level and standards of governance a fund applies and the "value" it places on risks to be managed which can vary even amongst mandates of a similar style and asset mix.

6.9 Specifically, the savings against the 'benchmark fund' arise from:

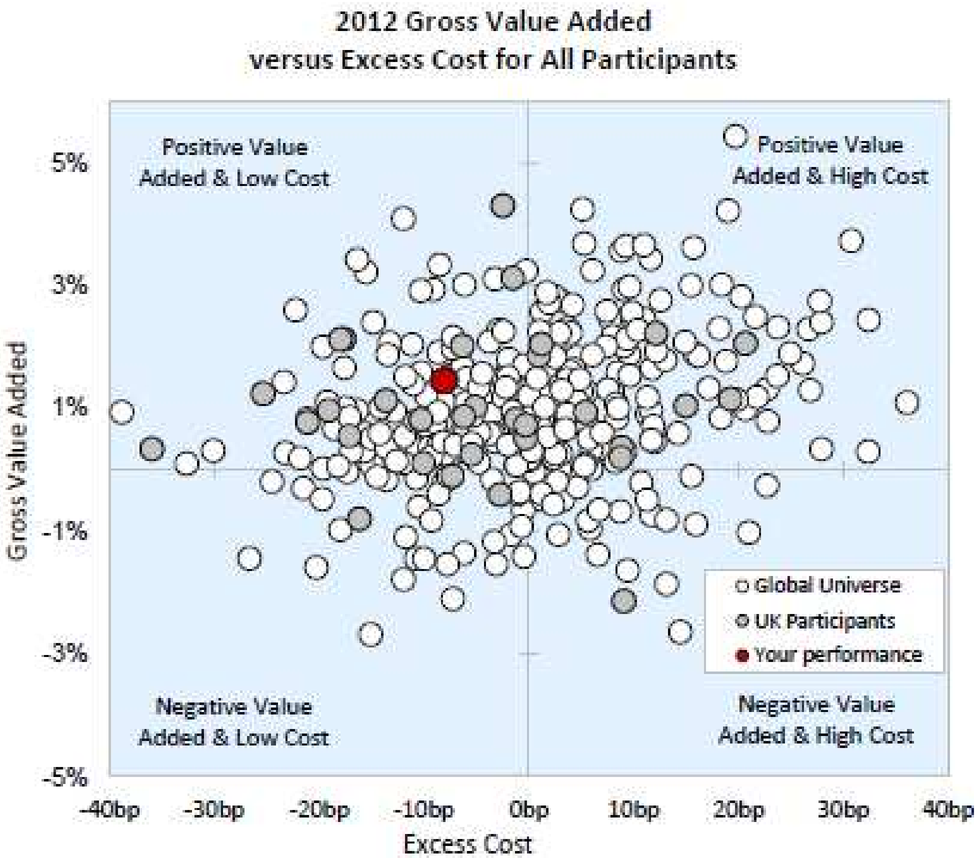
a) Implementation style – APF has a lower allocation (52%) to externally managed active mandates compared to the global median (68%) and LGPS median (70%). APF has a higher allocation (47%) to externally managed passive mandates compared to the global median (19%) and LGPS median (23%). Both these characteristics generate savings versus the benchmark fund.

Note: the areas where APF was more expensive versus the benchmark fund were in the lower use of internally managed funds, as APF manage no assets internally, and the higher use of the fund of funds structure (APF uses fund of funds structure for hedge funds and property exposure which is relatively more expensive than other structures).

b) Investment costs by asset class – APF's fees for passively managed mandates management are significantly lower than the global median and LGPS median.

c) Oversight, custody and other costs – APF's total costs of 2.8bps compared to the global median of 4.7bps. This saving is largely due to the lower custody costs incurred by the Fund due to its significant allocation to pooled funds. Obviously these costs are reflected in the net asset value of the pooled funds.

6.10 **Cost Effectiveness** - It is important to note that being high or low cost is not that meaningful in itself. The important question is whether the Fund is receiving sufficient value for any excess cost. The analysis of value added and total investment costs highlighted above is combined to evaluate overall cost effectiveness which is shown in the chart below. This concludes that APF has achieved a positive value added and at a lower cost than predicted by its benchmark fund and also shows how APF compares to the universe of funds analysed. This demonstrates that in achieving value added, the Fund has not had to incur costs at or above the benchmark fund costs.



6.11 The Fund recognises that further analysis is necessary and will continue to participate in this analysis as it develops to ensure meaningful comparisons are available to inform the on-going debate.

6.12 **Call for Evidence:** there were over 130 responses to the Call for Evidence. The current timescale of events on this going forward are as follows:

By 2/12/2013	Responses now being analysed by Shadow Board / LGA
By 9/12/2013	Hymans Robertson independently reporting to DCLG
On 16/12/2013	Shadow Board meeting to consider both sets of analysis
By end of year	Shadow Board recommendations to go to DCLG then on to Ministers
Spring 2014	Consultation from DCLG on flight of travel going forward

7 RISK MANAGEMENT

7.1 No specific issues to consider.

8 EQUALITIES

8.1 None as this report is primarily for information only.

9 CONSULTATION

9.1 This report is primarily for information and therefore consultation is not necessary.

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 The issues to consider are contained in the report.

11 ADVICE SOUGHT

11.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Alan South Technical Manager (Tel: 01225 395283) Liz Woodyard, Investments Manager (Tel: 01225 395306)
Background papers	*Regulations and accompanying notes;* *Call for Evidence;* *Centre for Policy Studies: LGPS Opportunity Knocks (2013)*
Please contact the report author if you need to access this report in an alternative format	