| Bath & North East Somerset Council | | |
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| MEETING: | **AVON PENSION FUND COMMITTEE** | |
| MEETING DATE: | **27 JUNE 2014** | **AGENDA ITEM NUMBER** |
| TITLE: | **LGPS STRUCTURAL REFORM CONSULTATION** | |
| WARD: | ALL | |
| **AN OPEN PUBLIC ITEM** | | |
| List of attachments to this report:<br>Appendix 1 - LGPS: Opportunities for collaboration, cost savings and efficiencies consultation document<br>Appendix 2 – Avon Pension Fund Draft Response | | |

## 1 THE ISSUE

1.1 The DCLG issued a consultation, LGPS: Opportunities for collaboration, cost savings and efficiencies in early May. This consultation follows the analysis of the responses to the Call for Evidence on the future structure of the LGPS in 2013 and the supplementary cost-benefits analysis of proposals of reform.

1.2 This report sets out the background to the consultation and the Fund's draft response.

1.3 The deadline for responses is 11 July 2014.

## 2 RECOMMENDATION

**The Committee:**

2.1 Approves the draft response to the consultation, LGPS: Opportunities for collaboration, cost savings and efficiencies.

## 3 FINANCIAL IMPLICATIONS

3.1 There are no financial considerations as this report is responds to an external consultation.

## 4 LGPS: OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES CONSULTATION PAPER

4.1 In 2013 the DCLG and LGA issued a joint Call for Evidence about increasing co-operation between local LGPS funds as a means to control administration and investment management costs. Building on the Call for Evidence and further cost-benefit analysis of potential options (commissioned from Hymans Robertson), this consultation is the next step in the reform of the scheme.

4.2 The consultation paper (see Appendix 1) sets out the Government's preferred approach to reform and seeks views on its proposals. The Government believes there is scope for significant savings of around £660m per year to be achieved through reform.

4.3 The proposals set out in the paper are:

a) Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping funds to invest more efficiently in listed and alternative assets and to reduce investment costs.

b) Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market.

c) 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.

d) A proposal not to pursue fund mergers at this time.

4.4 In addition the Government has decided not to consult on administration reform at this time. The Call for Evidence highlighted the scope for potential administrative efficiencies but the Government proposes to allow the administrative arrangements for the 2014 Scheme to mature before considering reform any further.

4.5 The priorities set out in the Call for Evidence of reducing fund deficits and improving investment returns were underpinned by one overarching objective: that the Scheme remains sustainable and affordable for employers, taxpayers and members in the long term. This consultation focuses on improving investment returns through lower investment costs. Respondants are also invited to submit any feasible proposals for the reduction of fund deficits.

## 5 DRAFT RESPONSE

5.1 The Fund's draft response is in Appendix 2.

5.2 The main points are as follows:

a) The key to delivering good investment and administration performance and value for money is good governance through ensuring there are appropriate skills and expertise throughout the governance structure.

b) LPGS governance is currently being strengthened and the new arrangements should be allowed to bed in before further changes are made. Reform needs to promote best practice and not force change or dilute the superior performance of funds that are already delivering. The consultation suggests that all funds should be brought down to the “average” rather than bring all funds up to the highest level of performance and best practice.

c) There is no consideration of investment risk in the consultation. Each LGPS fund has an investment strategy linked to its funding strategy which is specifically structured to defray the cost of the pension liabilities over a long time frame and to maintain as stable as possible the pension costs for the employers. The investment objective will reflect the risk adjusted return required to meet the funding requirement, and will therefore reflect the level of risk that can be passed on to employers through their pension contributions.

d) We support the use of any initiatives including collective investment vehicles (CIVs) that help reduce costs and/or provide access to a wide range of investment opportunities. However, the use of such vehicles or initiatives should be at the discretion of each fund to ensure they invest efficiently and meet their investment and funding objectives. Centrally prescribed policy will not necessarily achieve this. Strategic investment decisions are not simply about asset allocation; they are about managing the strategic risks *relative to* the liabilities. Therefore any changes in regulations must ensure funds have the flexibility to implement strategies to efficiently manage these risks.

e) The use of passive management is not low risk as there are inherent risks of concentration, valuation bias for example and if adopted across all quoted assets could give rise to systemic risk across the funds. From a risk perspective mandatory use by all funds is not appropriate.

f) Active management when effectively applied can add value and enhance returns net of fees. In recent years there has been greater use of risk based strategies to manage liability risk but these strategies can be more costly to implement due to their complexity. Funds need the flexibility to access such strategies either within or outside a CIV.

g) Reduced use of fund of funds for alternatives would reduce costs as it would eliminate a layer of fees. However, if these assets are collectively managed, there will need to be a robust governance structure in place to take on the management of these assets (including the selection, due diligence and monitoring of managers) to ensure there is not an increase in risk and potential reduction in returns if, as a result, there is restricted access to best in class managers. As a result, there will be additional management fees arising from managing these assets via a CIV.

h) There is no understanding of how responsible, sustainable or long term investing approaches as put forward by the Kay Review would be incorporated in these proposals. Passive investing requires even more rigorous corporate governance, environmental and social risk input. Greater passive investing will leave UK markets more exposed to decisions of short term investors whose actions are not so aligned with long term pension fund investors and expose all Pensions funds to the fragility of the economic cycle.

i) In the absence of more radical reform of the benefits structure then the most appropriate solution to managing the deficits is to tackle the main structural drivers, low bond yields and longevity. Changes to the benefits structure to manage improving longevity in 2008 and again in 2014 have had limited impact on reducing costs. Although the current very low bond yields reflect economic conditions, over a prolonged period there has been a structural impact arising from a lack of supply of long dated index linked gilts. Greater issuance of these bonds or a long dated "LGPS" bond could assist funds to better match their liability profile at an appropriate valuation level. There is a danger that solutions to tackle current pressures on deficits are introduced just as the interest rate cycle turns positive for pension funds; a 1% rise in bond yields, which is not inconceivable, would reduce the value of liabilities significantly and alleviate immediate cost pressures.

5.3 The deadline for the response is 11 July 2014.

5.4 The Committee is asked to approve the draft response.

## 6 RISK MANAGEMENT

6.1 An effective governance structure, defining clear responsibilities, and ensuring that the decision making body has an adequate level of knowledge and access to expert advice, is a key aspect of the risk management process.

## 7 EQUALITIES

7.1 For information only.

## 8 CONSULTATION

8.1 No relevant.

## 9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 The relevant information is set out in the report.

## 10 ADVICE SOUGHT

10.1 The Council's Monitoring Officer (Divisional Director – Legal and 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.

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| **Background papers** | |
| **Please contact the report author if you need to access this report in an alternative format** | |