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Appendix 1

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Dear Ms Edwards,

Call for evidence on the future structure of the Local Government Pension Scheme

Thank you for the opportunity to respond to the above call for evidence on the future structure of the Local Government Pension Scheme (LGPS). We have structured our response around the questions posed.

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.

The current structure of the LGPS works well in this respect. In Devon's case the Investment and Pension Fund Committee provides strong local accountability to local taxpayers, employers and members of the Pension Fund. In addition there are annual communications events with local employers and members of the Fund. The current structure thus fits in well with the Government's Localism agenda. The production of an Annual Report ensures that data on costs, income and investment performance are provided for the Fund.

A Fund covering a wider area would reduce the level of local accountability. It would inevitably be more difficult to involve local employers and members of the pension fund in overseeing the Fund, and the Fund would be less accountable to local taxpayers, as the Fund would be more distant from the local communities it served.

Question 2 – Are the high level objectives listed above 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?

We support the high level objectives listed, but in addition we think the high level objectives should include the delivery of good quality, sustainable pensions, and ensuring accountability to local taxpayers.

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We aim to provide a high quality pension to those working for the organisations that contribute to the LGPS, but the cost of the pension to local taxpayers is a prime consideration. Reducing deficits is clearly a key element of continuing to be able to provide a decent pension whilst keeping employer contribution rates to an acceptable level.

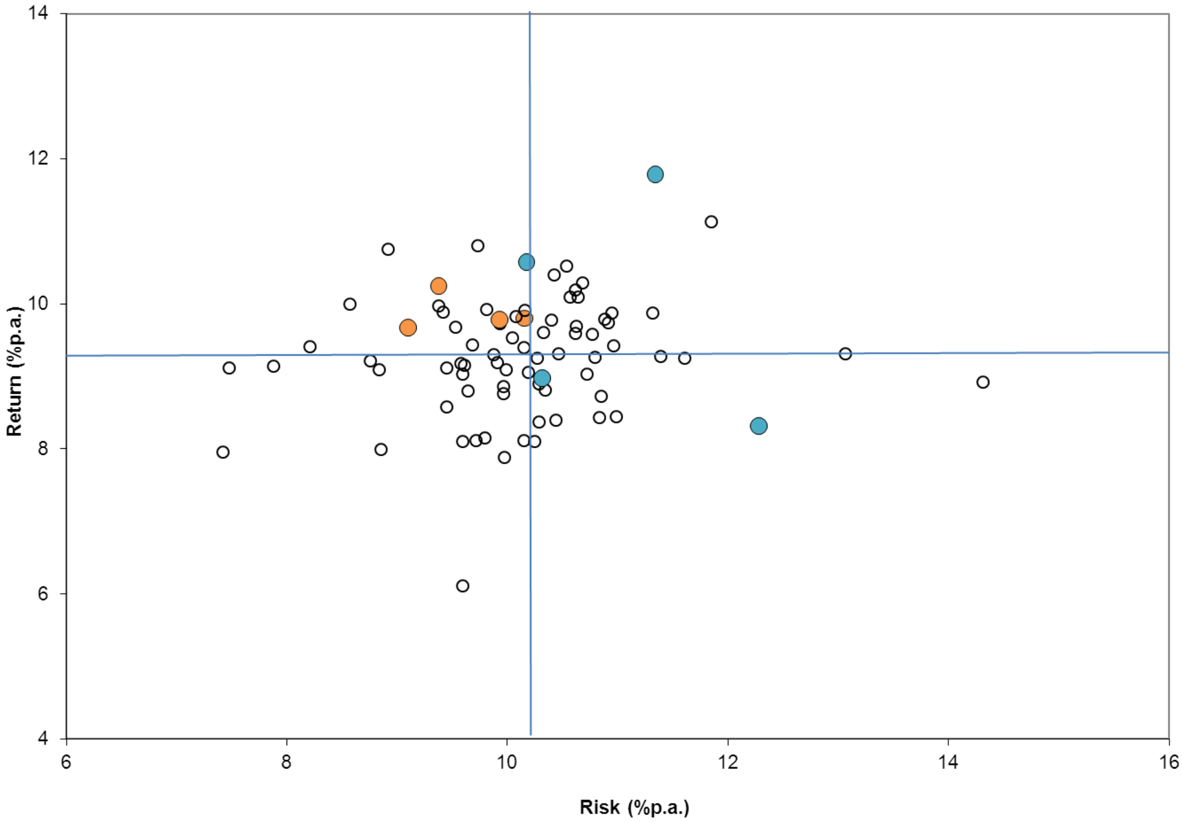
Investment performance is the key to keeping down the cost to the local taxpayer. A small under or over-performance in relation to investment returns will have a far greater impact on the ability to meet future liabilities than reductions or increases in the administrative and investment costs of running the Fund. The Devon Pension Fund had net assets of just over £3billion as at 31 March 2013. A 0.5% under-performance of investment returns would therefore cost the Fund £15million, which is nearly twice the total of the pension administration and investment management costs of running the Fund, which totalled £8.6m in the 2012/13 financial year.

Therefore it is vital to get the investment strategy correct, and to tailor it to the local situation in terms of fund liabilities, something that would be more difficult to do with larger funds. Investment management fee levels will vary according to the investment strategy followed, and higher fees could be justified if they support the optimal investment strategy.

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

As outlined above in answer to Question 2, investment performance is key.

Performance figures compiled by WM Performance Services show a lack of correlation between the size of funds and their investment performance. Their numbers show that the largest local authority funds have done well, however so have some of the smallest – size in itself will not guarantee good performance. The chart below shows the returns for all the LGPS funds over the ten years to March 2013, with the four largest funds highlighted in orange and the four smallest highlighted in blue.



This demonstrates that creating larger funds is not the answer to achieving improved investment returns. In addition, the cost of transition from the existing fund structure into a revised structure is likely to be a significant cost, both directly in terms of administering the transition, and to investment returns.

The best option for reform, therefore, would be to promote greater collaboration between Funds, where that supports improved investment returns and reduced costs. There are already good examples of this taking place.

Examples include the collaboration to set up a £250m investment fund to back infrastructure projects that will boost local economic growth by Greater Manchester, West Yorkshire, West Midlands, South Yorkshire and Merseyside pension funds. The pension funds are planning to identify projects that meet their investment criteria and benefit local communities. Each fund will initially provide up to £50m. Investment could be available for roads, energy, water, waste and regeneration projects.

In addition a lot of collaborative work has been done on setting up framework agreements to reduce procurement costs. The Devon Pension Fund is proposing to use the national framework for custodians to appoint a new custodian for the fund when the current contract comes to an end in July 2013. The South West councils have had a number of framework agreements in place over the last few years.

Another local example of collaboration is that the Devon and Cornwall funds have for many years held joint training sessions for their Investment Committee members. This has enabled costs to be shared, and enabled us to obtain higher quality speakers.

The potential gains from collaboration already underway may be lost if LGPS funds are putting their effort into implementing a transition to new larger funds, rather than concentrating on improving their investment strategy.

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?

In addition to the points presented above in relation to investments, we would add the following in relation to the secondary objectives:

1. Flexibility of investment strategies – the key reform required is a full review of the LGPS Investment Regulations. The recent proposal to increase the 15% limit on investment in partnerships was a good move in the right direction, but needs to be followed up by a full review of the regulations.
2. Investment in infrastructure – LGPS funds are increasing their allocations to infrastructure, and will continue to do so where it is in the interests of Fund strategy and performance. This is a good area to promote collaboration between funds as in the examples already quoted. However the fiduciary duty of all LGPS Funds is to secure the best return for their members, and infrastructure investment must fit into this context.

In relation to improving the cost effectiveness of administration, this is an area where we believe increased collaboration between funds would be beneficial.

We have been working with Somerset County Council on the creation of a shared service for pensions administration. This work started in early 2012 and the shared service arrangement was finalised to commence on 1st September 2013, re-branded under the name "Peninsula Pensions".

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In the early stages of the project we did speak to other funds who had merged administration teams to learn from their experiences. We came to the conclusion that:

- All staff should be employed by the same employer to avoid different terms and conditions.
- One location.
- One system.

The Somerset staff (16fte) transferred to Devon (37 fte) on 1st September and will work from an office base in Exeter, although extensive home working/working from a Taunton hub is being offered to all staff. Work is progressing on moving both funds onto a single Heywoods Altair system in order to streamline administration.

The new shared service will enable both funds to provide a high level of service to our members at a significantly reduced cost from the investment that would have been required in both staff and systems if the shared service proposal had not been pursued. The overall cost savings are considerable.

The shared service will vastly improve the service provided to members of the Somerset fund, which should not be overlooked when considering the benefits or pitfalls of fund mergers or increased collaboration.

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?

As outlined above investment performance, together with the regulations determining the benefits payable, is the key factor in determining the cost of the LGPS to local taxpayers. Therefore data on fund performance is the key data. This should be analysed over multi-year periods to give a full picture of performance, given that the Fund is looking to meet liabilities stretching 40-50 years into the future.

As outlined earlier, it is difficult to compare the investment fees paid by different authorities, as they will vary according to the investment strategy being followed. Such comparisons should not be used as a blunt instrument to judge fund efficiency.

Pensions administration, however, is a useful area to benchmark, and data in relation to cost and quality should be assessed to understand the value for money provided. In order to compare funds for administration costs, care needs to be taken to ensure a like for like comparison. In the Devon fund, the administration team has been situated outside of the County Council centre with proper budget controls in place. This does mean that we know exactly what our administration costs are, as the admin team budget pays all the bills such as wages, rent, light and heat, postage etc. In contrast, we understand that many of our neighbouring funds have administration teams sat within corporate buildings with either no or little budget control and the cost split between the employer and pension fund is unclear.

We subscribe to the CIPFA benchmarking club though this suffers from the same issues highlighted above. Cost should not be compared in isolation and consideration of performance and the level of service provided to the members of the fund should be included.

It would be sensible for each LGPS Fund to submit the data outlined above to the Department for Communities and Local Government, and for it to be reviewed by the Scheme Advisory Board to be set up under the Public Service Pensions Act. Information could then be published both for individual schemes and for the LGPS as a whole. Such information could provide increased transparency to local taxpayers, promote greater value for money. It will be important, however, for information to be produced and updated on a consistent basis in order for it to be meaningful.

Much of the data above is already available. We would caution against seeking a significant amount of data beyond that which is already available, as this could add significant cost to the operation of LGPS Funds at a time when cost reduction is being looked for. Clear definition of the data required is also crucial to ensure that information on individual funds is truly comparable.

Conclusion

The Devon Pension Fund believes that increased collaboration and sharing of services between LGPS funds is the way forward to achieve improved performance, as opposed to a structural change involving the merger of funds. The Devon Pension Fund is already working towards this agenda through the setting up of Peninsula Pensions, initially as a shared pensions administration service with Somerset, but with the potential to expand to serve the wider region.

Yours Sincerely

Mary Davis
County Treasurer