

LGPS CONSULTATION: OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

- Recommendations:**
- (a) That Officers draft a response to the Consultation on LGPS Opportunities for Collaboration, Cost Savings and Efficiencies.**
 - (b) That the draft response be circulated to members of the Committee for comment.**
 - (c) That the County Treasurer in consultation with the Chairman be authorised to submit the final response on behalf of the Devon Pension Fund.**

1. Introduction

- 1.1. As the Committee will be aware, last summer the Department for Communities and Local Government (DCLG) issued a call for evidence on the future structure of the Local Government Pension Scheme. The Devon Pension Fund's response, agreed at the Investment and Pension Fund Committee on 13th September 2013, was one of 133 responses received by DCLG.
- 1.2. The Government have now published their response to the call for evidence, in addition to the report commissioned from Hymans Robertson on the costs and benefits of mergers or common investment vehicles. The Government have issued a further consultation document entitled "Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies." The consultation was issued on 1st May, with a deadline of 11th July 2014 for responses.

2. Government Response to the Call for Evidence

- 2.1 The Government have considered the importance of local accountability, and have recognised in their response that local determination of a fund's asset allocation was seen as a vital consideration amongst respondents to the call for evidence. They have also stated that any direct link between size and investment return in the LGPS is inconclusive, but the evidence appears to show indirect benefits of larger fund sizes. They have also considered the impact of mergers in terms of the potential transition costs.
- 2.2 Having considered these points the Government has decided not to consult on fund mergers at this time. Nevertheless, they believe there remains a strong case for achieving economies of scale and other benefits through the use of common investment vehicles.

- 2.3 In relation to the cost effectiveness of administration, respondents quoted examples of the benefits of shared services and the scope for potential administrative efficiencies. It was also recognised that whilst such savings are valuable, they are small in comparison with investment costs and the impact of investment performance. At this stage the Government proposes to allow the administration arrangements for the 2014 scheme to mature before considering reform any further. Peninsula Pensions will explore further shared opportunities as appropriate.

3 Consultation on Opportunities for Collaboration, Cost Savings and Efficiencies

- 3.1 The Consultation document issued by the Government makes two main proposals for reform. These are outlined below:

- 3.2 **Proposal 1: Common Investment Vehicles (CIVs)** – The Government are proposing to set up two CIVs, one for listed assets (for example UK equity, European equity, UK bonds, etc.) and one for alternative assets. The suggested advantages of using CIVs include:

- Reduced investment management costs as a result of economies of scale from aggregation of investments.
- Reduced transaction costs as the opportunities of netting the buying and selling of units in the fund would be greater.
- Improved transparency on the effect of asset allocation strategy – as funds would be subject to the same investment costs and asset managers, the effect of asset allocation and local decision making would be more transparently reflected in investment returns.
- Savings from ending the use of “fund of funds” arrangements for alternative assets.
- Greater ease of investment in infrastructure by providing a cost effective way to realise the scale needed.

- 3.3 The Consultation document asks four questions in relation to Proposal 1:

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

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

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 asset and alternative asset common investment vehicles?

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

- 3.4 **Proposal 2: Passive fund management of listed assets** – The LGPS currently makes use of both active management and passive management approaches. The Hymans Robertson report suggests that while some funds benefit from good active management, the returns achieved in aggregate for listed assets across the LGPS have been in line with the market. They

concluded that listed assets such as bonds and equities could be passively managed without affecting the total LGPS investment performance, whilst achieving around £230m saving in investment management fees.

3.5 The Government therefore wishes to explore how to secure value for money through effective use of passive management. There is a range of options open to achieve this:

- Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.
- Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.
- Fund authorities could be required to manage listed assets passively on a “comply or explain” basis.
- Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report.

3.6 The Consultation document asks the following question in relation to Proposal 2:

Q5. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

4 Conclusion

- 4.1 The Government’s decision not to consult on the merger of funds at this time and the proposal to keep decisions about asset allocation with the local fund authorities are to be welcomed. The use of common investment vehicles has a number of advantages, but the compulsory use of such vehicle will take some responsibility away from local funds.
- 4.2 With regard to the proposal on passive management, the Devon Fund has for some years had a higher allocation to passive than the majority of LGPS funds. However, the third and fourth options may be more reasonable approaches than a requirement to move all listed assets into passive funds.
- 4.3 As the consultation document was only issued in early May, Officers have had insufficient time to draft a considered response in time for the meeting. Therefore it is proposed that officers circulate a response in time for members to submit comments, and that the County Treasurer in consultation with the Chairman be authorised to submit the final response on behalf of the Devon Pension Fund.

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Electoral Divisions: All

Local Government Act 1972

List of Background Papers – Nil

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