
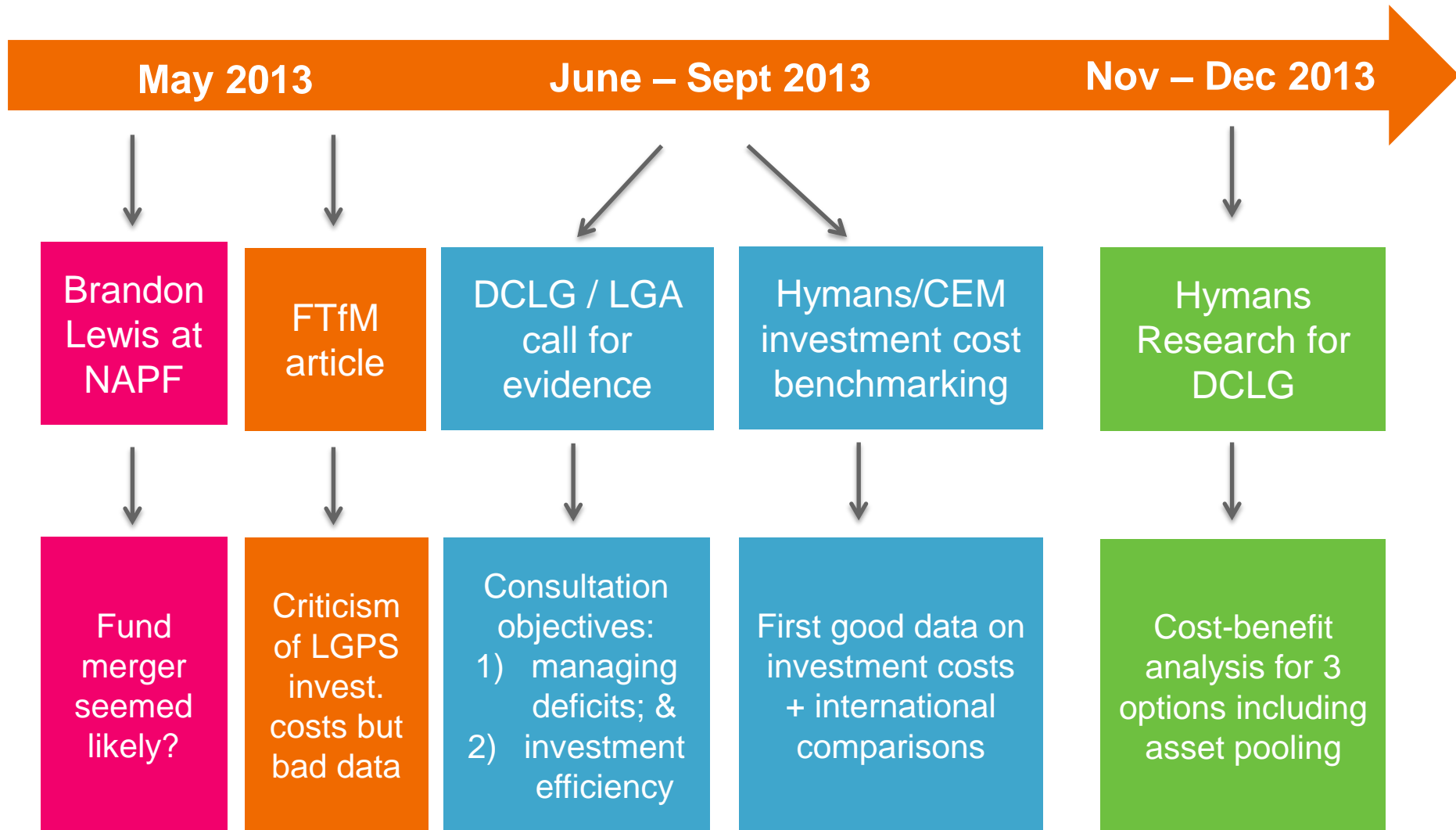


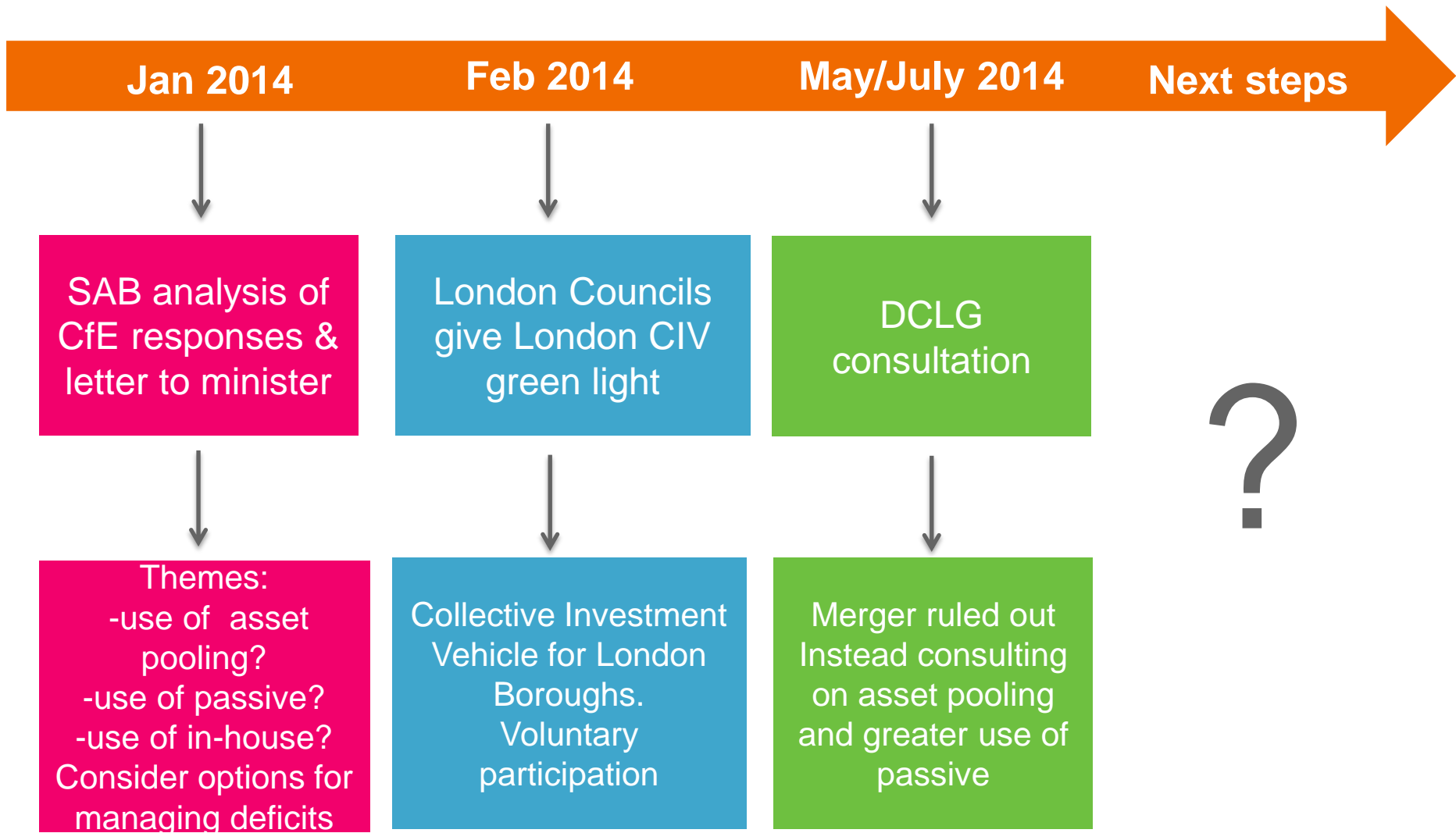
Update on Structural Reform and governance

- 
- Paul Potter, Partner
 - Roy Roach, Benefit Consultant
 - 24 November 2014

The background

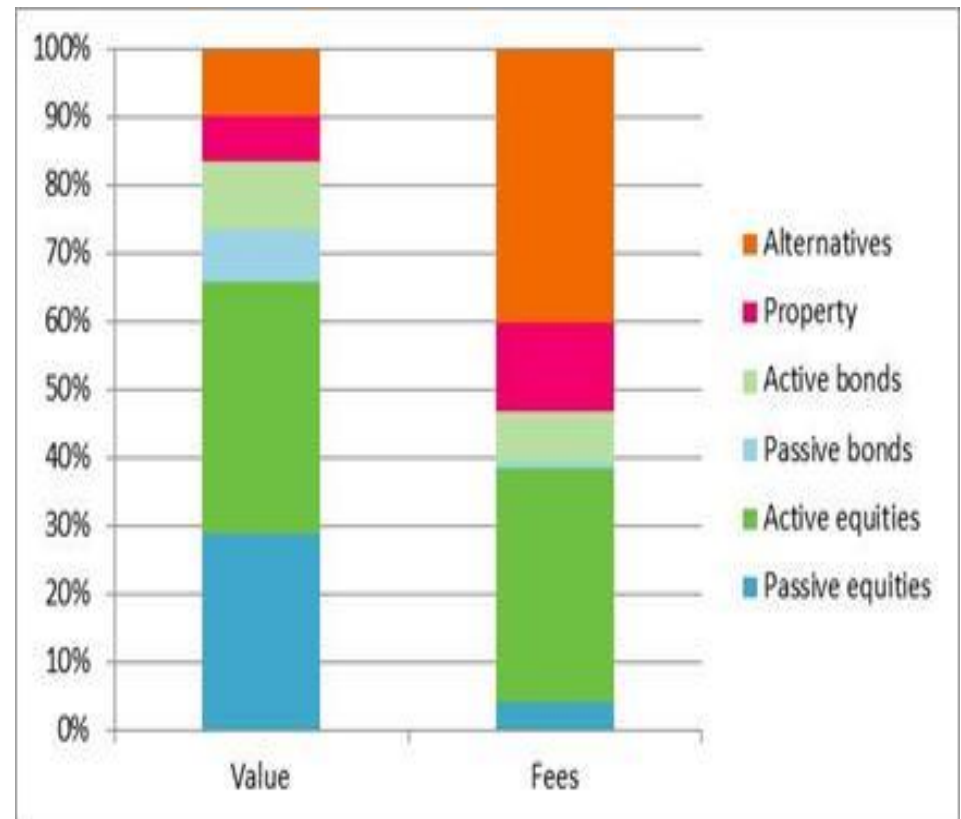


The background



Themes that emerged from the Call for Evidence

- Asset pooling as an alternative to fund merger
- Reduce use of Funds of Funds for alternatives
- Use of passive management for listed assets
- Governance is critical
- Local decision-making



“LGPS Structure Analysis”
Hymans Robertson,
December 2013

Consultation questions

- Q1. Would CIVs allow funds to achieve economies of scale?
- Q2. Keep decisions about asset allocation with local Fund authorities?
- Q3. How many CIVs and which asset classes?
- Q4. What type of CIV? What governance?
- Q5. Which option for passive investment offers best value for tax-payers:
 - 1) Compulsion (all listed securities to be passive)
 - 2) Specified %age passive or progressive increase
 - 3) “comply or explain”
 - 4) Funds simply be expected to consider the benefits



Q1: Do you agree that Collective Investment Vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments?

Challenges of CIVs for LGPS

- Some control over manager selection must be ceded
- Choices may be limited
- Increased manager concentration?

Benefits of CIVs for LGPS

- Scale benefits without fund merger
- Central monitoring and management
 - Time can be re-focused on strategy
- Improve the quality of decisions on managers?

Question 1 – in summary

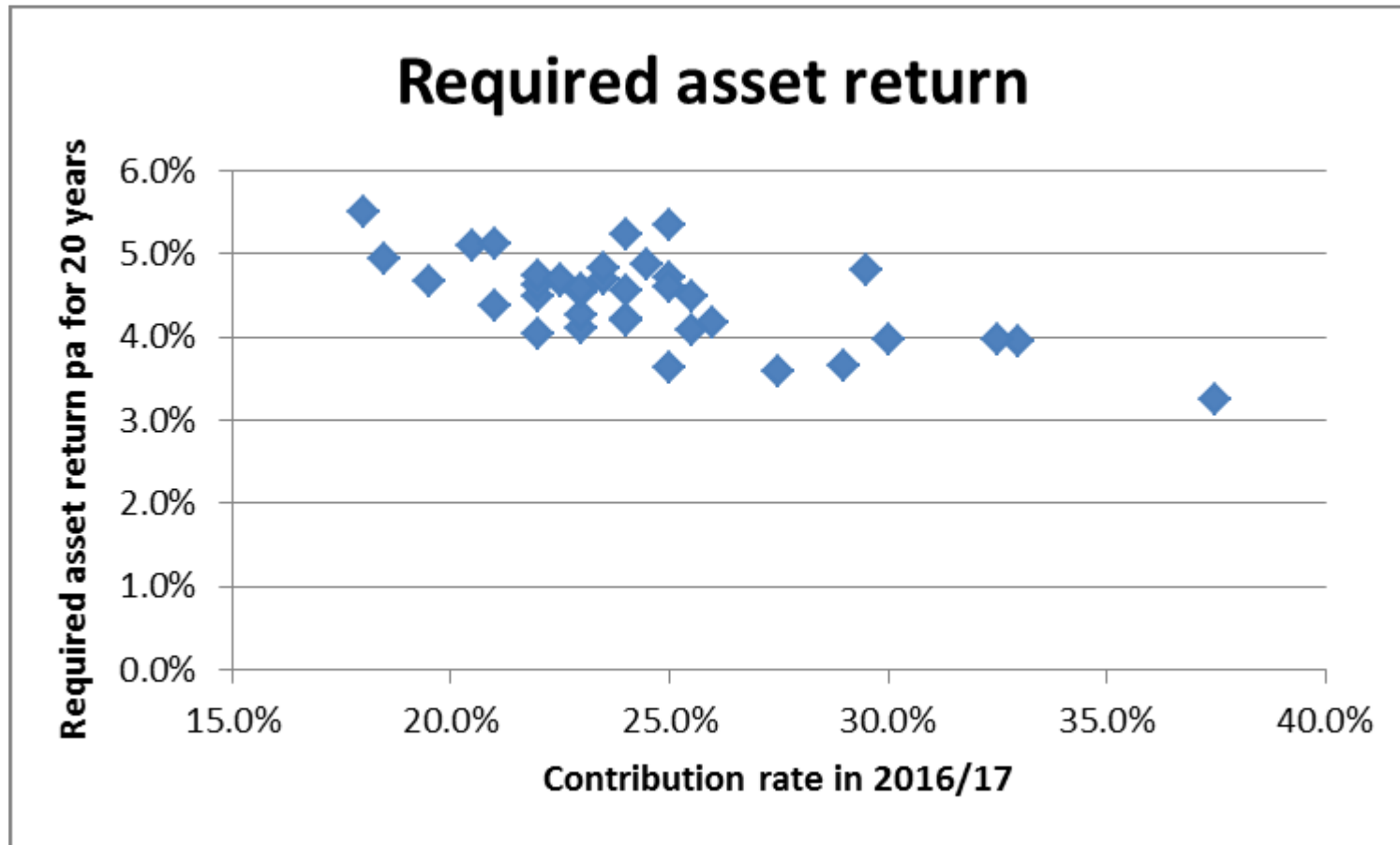
Do you agree that Collective Investment Vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments?

- Yes - scope for fee savings and governance benefits
- However, not going to be easy
- Other options may be sufficient for some specific investments e.g. frameworks for passive
- Governance will be key
- We do not believe in compulsion



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

Link between investment and funding strategies



Source: Hymans Robertson LLP, 37 funds on common assumptions at 2013 valuation

Why local accountability is important


All of the following may differ across authorities

- Objectives
- Attitudes to risk
- Profile of liabilities
 - Maturity
 - Cashflow
 - Range of employers
- Current funding position

Question 2 – in summary

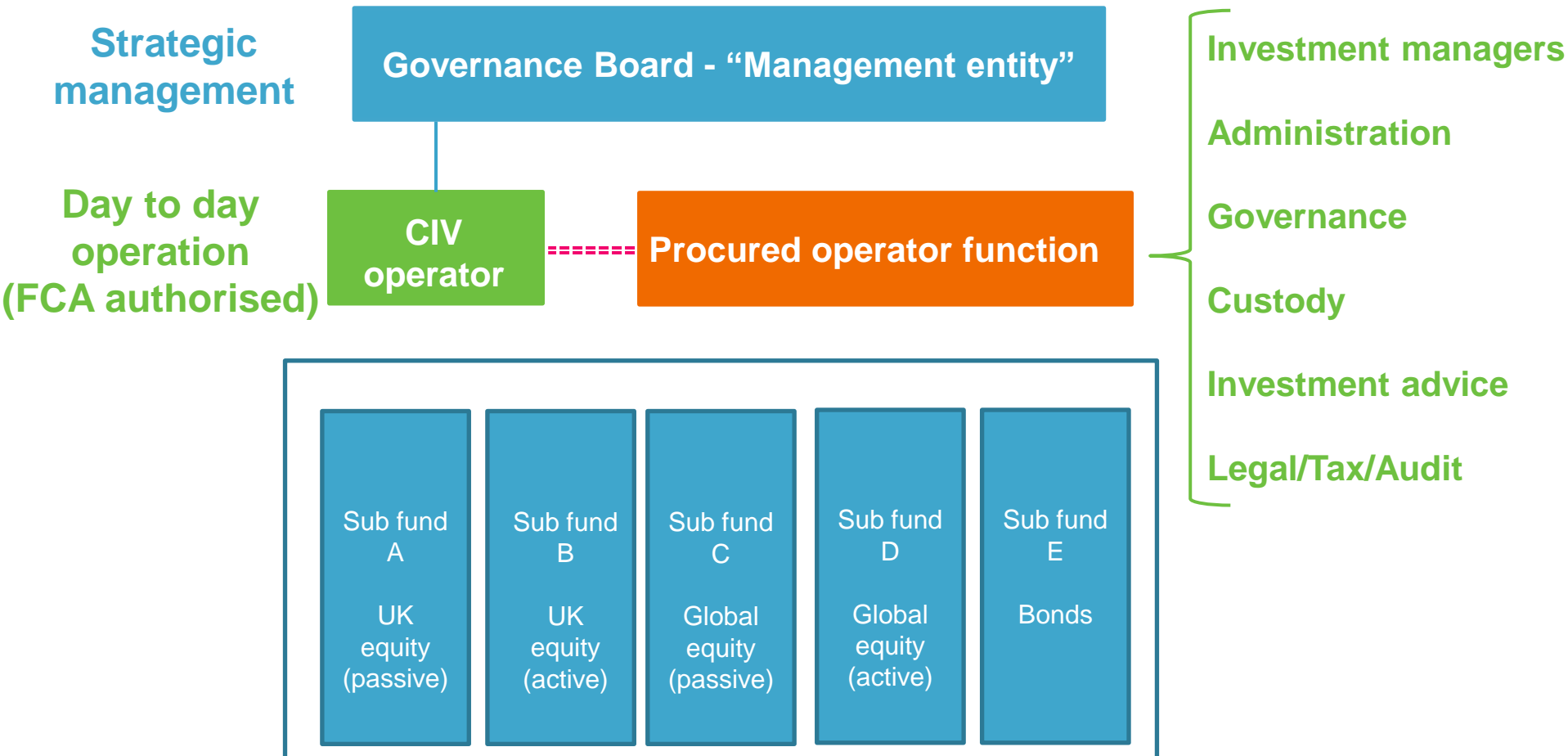
Do you agree with the proposal to keep decisions about asset allocation with local Fund authorities?

- Yes – Funds are not all the same!
- Robust, well governed decision making process required



Q3. How many CIVs should be established and which asset classes/categories should be represented in each of the listed and alternative assets?

Structure of an umbrella CIV



Could operate multi-manager approach within sub-funds


Why would you have more than one CIV?

- Allow participation in governance
- Avoid diseconomies of scale
- Allow for choice
- Type of CIV 'host'
 - LGPS – interests aligned
 - Corporates – with profit motive

Question 3 – in summary

How many CIVs should be established and which asset classes/categories should be represented in each of the listed and alternative assets?

- Appropriate number :
 - Passive 0 or 1 likely to be desired position
 - Active >1 but <10 most likely
 - Alternatives 1
- Focus on core asset classes and mandates at initial stages
- Evolve as Funds' needs change
- Alternatives - a longer-term project



Q4. What type of CIV would offer the most beneficial structure? What governance structures should be established?

Fund structure - desirable characteristics

- Segregation of sub-funds
- Tax efficiency and transparency
- Low operating costs
- Investment efficiency and flexibility

Governance - desirable characteristics

- Adequate resources overseeing and running the CIVs
- Focus on appropriate decisions and timeframes
- Investor representation
- Good communication with investors

Question 4 – in summary

**What type of CIV would offer the most beneficial structure?
What governance structures should be established?**

- Range of funds offer the desired characteristics, but Authorised Contractual Scheme looks to best positioned from tax perspective
- Investment team
 - Responsible for provider appointments, day to day management of CIV and communication
 - Interests aligned with LGPS funds
- Strong oversight required



Q5. Passive investment - which option adds best value for taxpayers, scheme members and employers?

Options proposed

- Compulsory - 100% passive for listed assets
- Compulsory - a fixed % for listed assets
- A “comply or explain” approach
- Funds to consider benefits of both active and passive management

What are we trying to achieve?

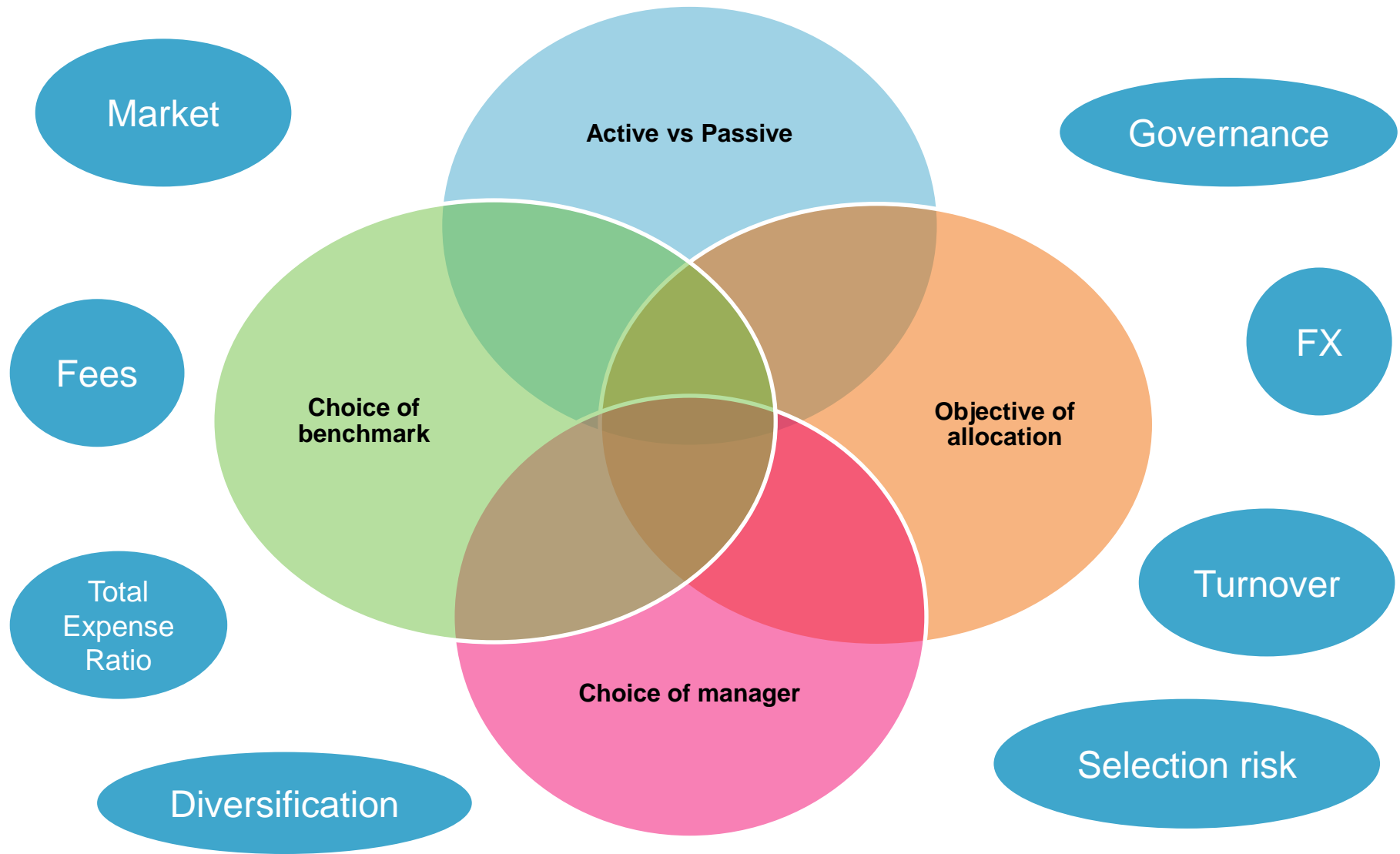
‘...the best chance of delivering the returns required to close the deficit, ideally with low volatility...’

i.e. maximise confidence in favourable outcomes

‘It is better to earn the extra return you need from a number of sources rather than depending purely on fee savings.’

We don't like 100% of anything

Structural components of equity decisions



Elements of our blueprint for listed equities

Suggested sources of 'savings'

Fee reduction from using more passive (but not 100%)

Smarter benchmarks as part of passive component

Collective fee savings (through CIVs)

Improved governance around active manager appointments

Reduced turnover costs

Potential savings meet (and exceed) Government target

Smarter benchmarks

Returns (% p.a.)	5 years to 2009	5 years to 2014	10 years to 2014
FTSE All Share	1.4	17.2	9.0
FTSE All Share 5% cap weight	1.8	17.8	9.5
MSCI AC World	2.6	15.5	8.9
FTSE RAFI All World	4.2	18.3	11.1

Effective Turnover	US	Developed ex US
Market cap 1000	4.2%	6.9%
RAFI 1000	9.2%	12.0%

Source: Research Affiliates, The market impact of index rebalancing

- Smart benchmarks typically include better diversification than market cap, limiting stock specific exposure.
- A common feature of most smart benchmarks and active “smart beta” is rebalancing
- Rebalancing incurs transaction costs, but is shown to add value net of these costs by most academic research
- **Conclusions: transaction costs are not automatically a bad thing. It depends how, why and the extent to which they are incurred.**

The future of the LGPS: Hymans Robertson's beliefs

- CIVs have the potential to achieve benefits of scale and good governance
- There is scope to increase the use of passive management...
 - Some characteristics of active management can be replicated 'passively'/systematically at lower cost
- ...but active management has a role
 - Where there is evidence of an ability to consistently add value
 - For more complex and less liquid asset class
 - Improved governance around manager appointments is key

What next?

- Response to consultation expected this year
 - A further consultation on specific proposals?
 - What degree of compulsion, if any?
 - Will the environment of uncertainty continue .. and for how long?

Thank you



<http://www.hymans.co.uk/knowledge-centre/publications.aspx>

<http://www.hymans.co.uk/blog.aspx>



Governance Update

Topics

- Local Pension Boards
 - The role
 - Membership
 - Requirements for members
 - The local pension board

Recap



- Hutton Report
- March 2011



- Deliver improvements, ensure fairness and transparency

- Royal assent April 2013

- Consultation closed 21 November 2014

- Established by 1 April 2015

The Role of the Local Pension Board

- Assist the administering authority in securing compliance with:
 - “Scheme” regulations
 - Legislation relating to governance and administration
 - Pension Regulator’s requirements e.g. Code of Practice
- To ensure effective and efficient governance and administration of the Scheme

The Role of the Local Pension Board

- Ensure decision making processes followed properly
- Ensure policies and procedures are in place
- Ensure the Fund understands the Pensions Regulator's requirements
- Bring a stronger employer, scheme member voice to the Fund's governance
- **But *not* to exercise delegated administering authority functions**

The Pensions Regulator's Code of Practice

Governing your scheme

- Knowledge and understanding required by pension board members
- Conflicts of interest
- Information to be published about schemes

Managing risks

- Internal controls

The Pensions Regulator's Code of Practice continued

Administration

- Scheme record-keeping
- Maintaining contributions
- Information to be provided to scheme members

Resolving issues

- Internal dispute resolution
- Reporting breaches of the law

Membership of the Local Pension Board

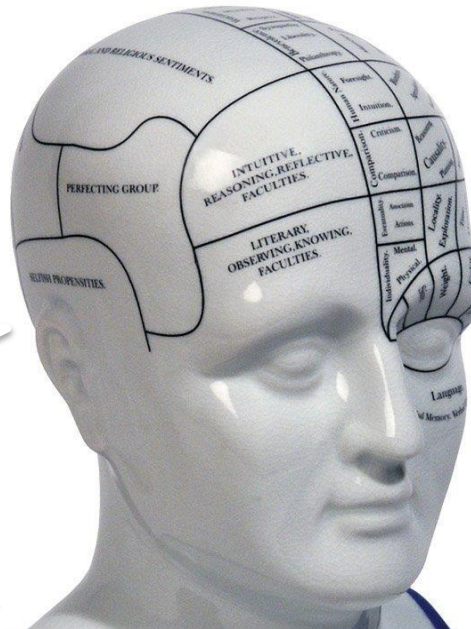
- Equal number of employer and scheme member representatives (at least 2 each)
- Apparently no limit on independents
- No officer or elected member carrying out other LGPS functions may sit on a local pension board
- No conflict of interest
- Relevant experience and capacity

Knowledge and Skills

LGPS and wider pension law

Regulator's code of practice

Fund documents and policies



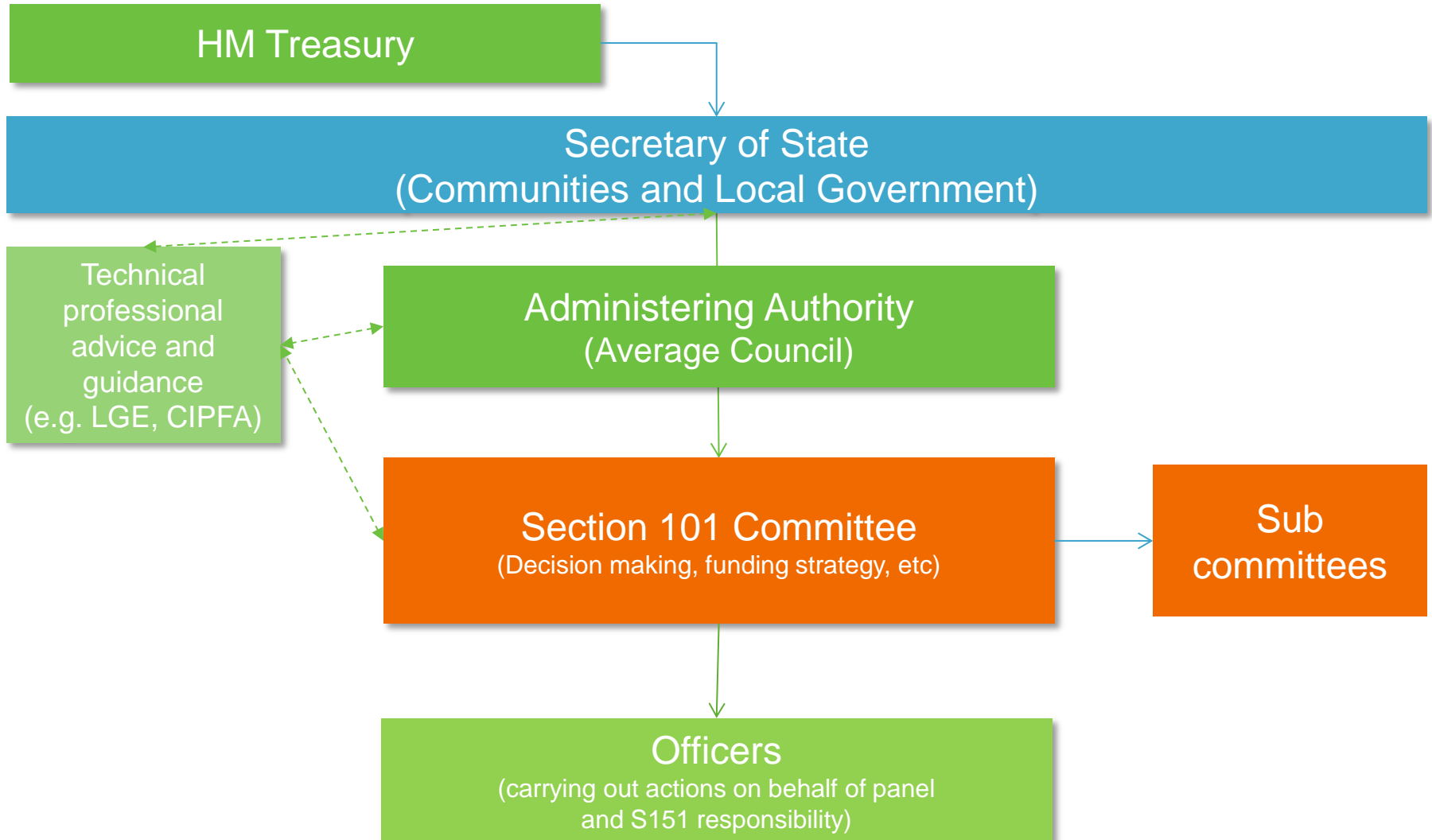
Individual requirement

Training will be essential

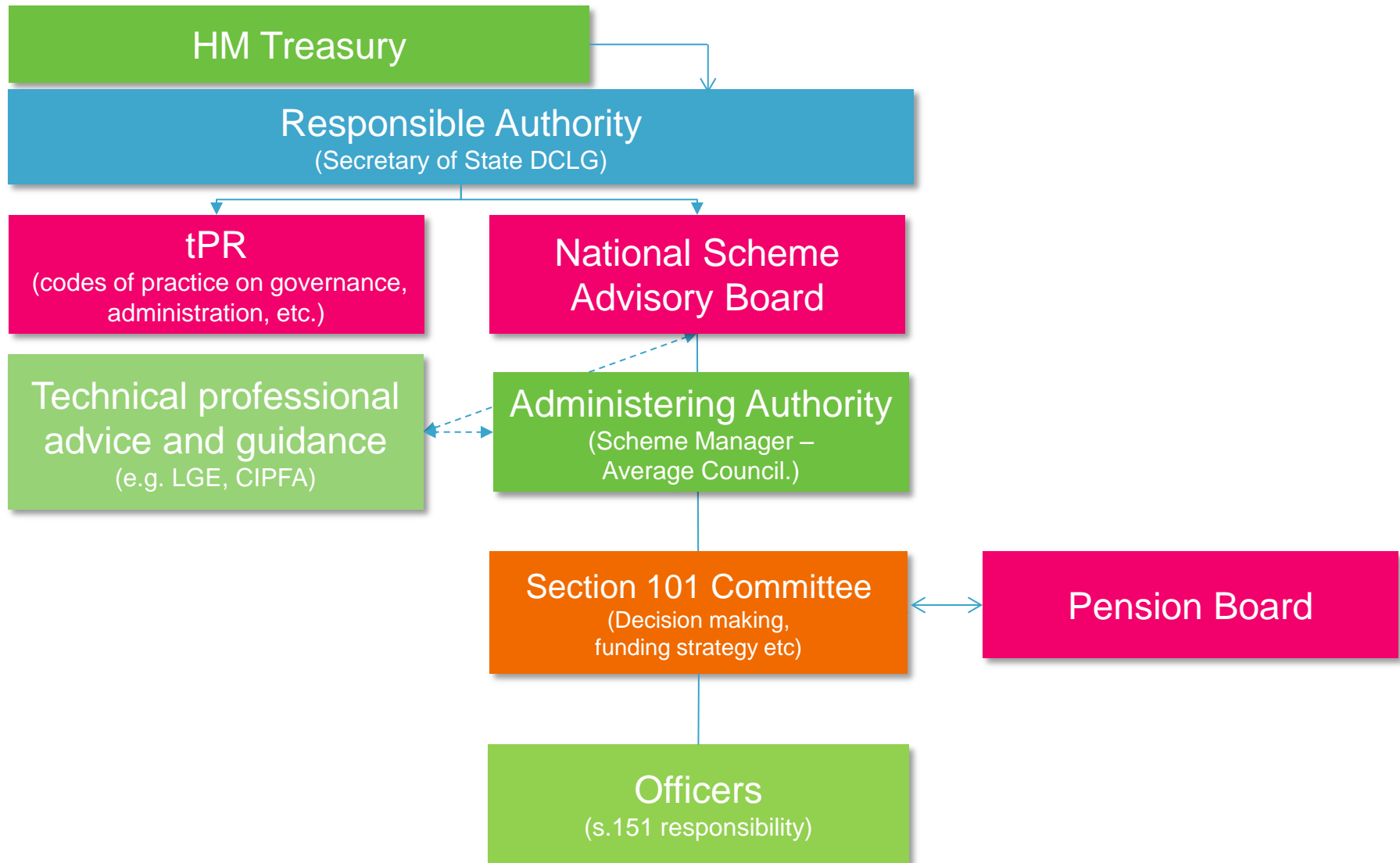


Average Pension Fund

Current Fund governance structure



Future LGPS governance structure



Appointing the Pension Board

- Proposal to committee for Proposed LPB
 - X scheme member representatives
 - X Employer representatives
 - Y Independent
- Communication of process
- Role for the unions ?
- Selection or election ?
- Remuneration ?

Responsibilities....

- Controls in place
- Procedures documented
- Monitoring
- Management reports
- Corrective procedure

Outsourcing does not absolve responsibility
– management of suppliers

Every one has a part to play

Get
contributions
right

Paying the
right pension



Data is up
to date and
relevant

Meet
deadlines

Keep the people who need to know informed

And everyone benefits

Scheme members get a better service
Makes things more efficient

The next steps

86 working days left !

Determine approach and explore options based on draft regulations
December 2014

Regulations and tPR's Code of Practice laid December 2014

Finalise set up
January 2015

Council approval
February/March 2015

Implement – appointments
February – March 2015

Inductions March 2015 (ongoing)

A bit of work to do



Go live April 2015

A framework for best practice governance





Thank you

Any questions?