

Pension Fund Committee

5 September 2013

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



Report of Don McLure, Corporate Director, Resources

Purpose of the Report

- 1 The purpose of this report is to ask Members to agree a response to a recent call for evidence on the future structure of the Local Government Pension Scheme (LGPS).

Background

- 2 On 21 June 2013 the Local Government Association (LGA) and the Department for Communities and Local Government (DCLG) issued a joint call for evidence into ways to increase co-operation between LGPS Funds. A copy of the letter is included at Appendix A.
- 3 The call for evidence follows moves already put in place to increase transparency and standardise data across the schemes so that fund managers, pension holders and the public can compare performance between funds and identify possible savings. These steps will be introduced next year. The call for evidence will help inform a consultation to be put forward later in the year which aims to set out a number of broad principles for updating the LGPS to improve efficiency and cost-effectiveness. All interested parties are invited to contribute their ideas. The closing date for submissions is 27 September 2013.

Response

- 4 A proposed response to the call for evidence is included at Appendix B.

Recommendation

- 5 Members are asked to agree the response set out in Appendix B can be submitted, or to suggest any required changes.

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Department for Communities and Local Government



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

Background

In 2010, the Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission. The purpose of the Commission was to review public service pensions and to make recommendations on how they could be made sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers. Lord Hutton's final report was published on 10 March 2011. Among its recommendations, the report made clear that the benefits of co-operative working between local government pension scheme funds and achieving administration efficiencies more generally should be investigated further. The Local Government Pension Scheme currently costs local taxpayers £6 billion a year in employer contributions.

Recommendation 23: *Central and local government should closely monitor the benefits associated with the current co-operative projects within the LGPS, with a view to encouraging the extension of this approach, if appropriate, across all local authorities. Government should also examine closely the potential for the unfunded public service schemes to realise greater efficiencies in the administration of pensions by sharing contracts and combining support services, including considering outsourcing.*

Lord Hutton went on to comment about the need for change and improved scheme data. At paragraph 6.1 he said:

In its interim report, the Commission noted the debate around public service pensions is hampered by a lack of consensus on key facts and figures and a lack of readily available and relevant data. There are also inconsistent standards of governance across schemes. Consequently it is difficult for scheme members, taxpayers and commentators to be confident that schemes are being effectively and efficiently run. It also makes it more difficult to compare between and within schemes and to identify and apply best practice for managing and improving schemes.

On 16 May 2013, the LGA and DCLG held a roundtable event on the potential for increased co-operation within the Local Government Pension Scheme, including the possibility of structural change to the current 89 funds. 25 attendees represented administering authorities, employers, trade unions, the actuarial profession and academia.

The roundtable aimed to bring objectivity and transparency to the subject through open debate. There was a full discussion of the possible aims of reform and the potential benefits of structural change, together with the further work needed to provide robust evidence to support emerging options. The meeting focused on the issues to be addressed by reform rather than the detailed arguments for any of the potential ways forward that have been proposed.

The roundtable heard about the projects being undertaken to look at the options for structural reform of the Scheme in London and Wales and considered the range and relative priorities of the desired outcomes of reform, the data requirements for determining a start point and target and the next steps for delivering those outcomes. On 22 May at the National Association of Pension Funds' local authority conference, the Local Government Minister Brandon Lewis said:

I am determined that we make progress and make it as quickly as reasonably possible. I can therefore announce this morning, that we will consult later in the year on a number of broad principles for change. This will be your opportunity to tell us what reforms could be made to both help improve your investment performance and reduce your fund management costs.

The consultation will not set out some pre-determined solution to what is undoubtedly a complex and contentious issue. I am neither ruling anything in nor ruling anything out at this stage. However, the clear message from me this morning is that I am not wedded to the existing number of 89 funds in England and Wales. If it takes a smaller number of funds to improve the efficiency and cost-effectiveness of the scheme, I shall not shy away from pursuing that goal.

I have talked a fair amount about the need for robust data to inform decisions. I am therefore working with the LGA and others to launch a call for evidence, which will both inform our consultation and help all involved formulate their views in response to the consultation.

You will be aware that work is well underway to establish a shadow national pensions board for the Scheme. I have met with the LGA and local government trades unions on several occasions to discuss the sort of work that I would like the board to undertake.

This document sets out the call for evidence from DCLG and the LGA, working with the Shadow Scheme Advisory Board, and explains how it will feed into the forthcoming consultation.

The call for evidence

At the roundtable, the following high level and secondary objectives for structural reform were proposed:

High level objectives

1. Dealing with deficits
2. Improving investment returns

Secondary objectives

1. To reduce investment fees
2. To improve the flexibility of investment strategies
3. To provide for greater investment in infrastructure
4. To improve the cost effectiveness of administration
5. To provide access to higher quality staffing resources
6. To provide more in-house investment resource

The roundtable also agreed that, although there is a wide range of data available on Local Government Pension Scheme funds, it is currently widely dispersed and would benefit from enhancement, collation and further analysis. It also considered how best to achieve a high level of accountability to local taxpayers, particularly if services are to be shared or funds merged.

In your response to this call for evidence, it would be helpful if you could have particular (although not exclusive) regard to the following questions and provide evidence in the form of annexes to support your answers.

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.

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?

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

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?

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?

Timetable

Responses to this call for evidence should be submitted in electronic form to Victoria Edwards at: LGPSReform@communities.gsi.gov.uk
The closing date for submissions is 27 September 2013.

The submissions will then be analysed by DCLG and the LGA, working with the Shadow Scheme Advisory Board. You may be asked to provide further clarification and/or evidence to support your answers during that process.

The analysis of submissions will then inform a formal consultation on the options for change to be published by DCLG in the early autumn.

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 Local Government Pension Scheme (LGPS) is already able to demonstrate a high level of accountability to local taxpayers and other interested parties, and it is a good model for localism with democratic accountability. The underlying assumption behind the call for evidence appears to be that it would be a good idea to reduce costs by reducing the number of LGPS Funds. However, combining or reducing the number of administering authorities / Pension Funds would appear to run counter to the localism agenda and would dilute the local nature of the LGPS. Also, there are significant risks and challenges associated with merging LGPS Funds, these include:

- A potential democratic deficit through the loss of the link between elected members sitting on Pensions Committees and local voters.
- Local councillors may not be able to influence decisions taken by the Fund Committee, so decisions taken at a more regional level could impact on local council tax levies but without local councillors having whole control over these decisions.
- Risk would be spread over fewer Pension Funds. At present, one advantage of the current number of LGPS Funds is that it ensures investment diversification across the LGPS as a whole. This advantage could be reduced significantly if the number of Funds was reduced.
- A reduced number of regional LGPS Funds could have a major impact on a company or sector if the Fund Committee decided to stop investing in that company or sector.

Although not insurmountable, there would also be significant practical issues in merging Funds, including the following:

- Problems with exiting from existing contractual obligations (for pension administration, payroll and ICT systems for example), a significant exercise in moving and collating scheme member data onto a single platform and in transferring pensions payroll data.
- Potential loss of experienced staff (currently based in 100 administering authorities around the UK)
- The LGPS would become more remote from scheme employers, scheme members, local trade union officials etc, there would be loss of current knowledge of local employers' culture and ways of working
- Possible increase in costs compared to the cost of some of the existing administering authorities
- Cost savings arising from economies of scale may be offset by a need for local contacts / pensions liaison officers to maintain contact with employers and employees

- There would be issues over what to do with Police Pension Scheme and Firefighters' Pension Scheme administration where this is currently undertaken by the LGPS administering authority

Nevertheless, there would be potential administrative advantages to merging LGPS Funds including:

- Economies of scale for example on printing costs, system costs, central overhead costs, reduction in committee member costs (due to reduction from current 100 separate pension committees, pensions advisory committees, etc)
- A reduction in number of separate policies required for each Fund
- Potential to negotiate better contract terms with suppliers
- Better standardisation and consistency of approach
- Reduction in fees for managers and advisers

The Council believes it is possible for the LGPS to further develop existing examples of partnership working without having to formally merge Funds. This would allow the LGPS to retain a local focus but still potentially benefit from economies of scale where this is appropriate. LGPS Funds already work together along with private sector partners to deliver better value to taxpayers – joint working over pensions administration software is a good example of this. Shared procurement exercises are another example of Funds working together to make better use of resources.

One area where shared working should be further developed is in access to investment fund managers. At present, it is often a costly and complex exercise for Funds to move money away from a poorly performing manager to another manager. It should be possible to better coordinate fund manager procurement between LGPS Funds so as to make it easier for all Funds to access a wider range of quality investment managers.

On the availability of transparent and comparable data on costs and income:

Transparent and comparable data on pension benefits administration is already available through an annual benchmarking exercise carried out by the Chartered Institute of Public Finance & Accountancy (CIPFA). The CIPFA Pensions Administration Benchmarking Club 2012 compared administration costs for 62 local authority LGPS funds. This showed that the average administration cost for local government is £18.45 per scheme member compared to private sector in-house costs of £47.00 per member and private sector outsourced costs of £41.00 per member.

The data on investment performance is harder to obtain and compare. DCLG publishes information on the cost per member of pensions administration and fund management for each LGPS Fund. However, the data by itself is not always helpful. For example, the cost of fund management should not be looked at in isolation – it is important to look at it in the context of the returns on investments achieved by the fund managers. There is little point in paying a low fund management fee if the consequence is having fund managers that underperform.

It would be helpful for DCLG to develop/promote and publish comparative data that looked at fund returns and the risk taken for those returns, as well as the basic fund management costs. This would allow best practice to be more clearly identified and would allow Funds to become more efficient and promote stronger investment performance.

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?

Yes – the high level objectives of dealing with deficits and improving investment returns are the ones that should be focussed on, although the former depends in part on the latter. The main challenge facing a defined benefit contribution scheme is controlling the contributions needed. As the future of the scheme liabilities is being dealt with by the 2014 reforms, it is correct to focus on the scheme assets.

Measuring investment return performance should include an assessment of the degree of risk taken to achieve returns, along with other factors such as the level of diversification within a portfolio.

Any comparison of deficit levels between Funds should take into account the different assumptions that Fund actuaries use.

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

Working on options to allow LGPS Funds easier access to a wider group of fund managers would help to achieve the objective of improving investment returns (and so reducing deficits).

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?

Secondary objectives were listed as

1. To reduce investment fees
2. To improve the flexibility of investment strategies
3. To provide for greater investment in infrastructure
4. To improve the cost effectiveness of administration
5. To provide access to higher quality staffing resources
6. To provide more in-house investment resource

Secondary objectives 2 and 4 would be met by making it easier for Funds to choose from a wider range of fund managers and move away from poorly performing managers where appropriate.

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?

Extensive comparative LGPS Fund administration data is already collected as part of the CIPFA Benchmarking exercise. There could be a requirement for Funds to participate in the exercise to increase the coverage. Data on investment returns, risk approaches and fund management costs should be collated centrally as well – either by DCLG the Government Actuary's Department or some other body. Funds should also be encouraged to share best practice regarding investments – this could be collected through a centrally administered questionnaire. Outcomes could be analysed by one of the groups set up to look at issues relating to the 2014 LGPS, or a separate group could be set up to carry out the analysis.