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LGPS Regulations
Department for Communities and Local Government
Zone 5/G6 Eland House
Bressenden Place
London
SW1E 5DU

Dear Ms Edwards,

<u>LGPS Call for Evidence</u>

I refer to the above, issued on 21st June, 2013. On behalf of Dyfed Pension Fund I detail below the responses to the questions posed and I have additionally identified further evidence which should be taken into account.

Background

A review of the Welsh LGPS structure has already been undertaken and the following four options were considered:

1. An "as is" option based on the current structure with 8 Funds which provides a benchmark position.

2. An "as is" but with enhanced collaboration (Joint procurement, shared working efficiencies etc.)

3. A mid range option based on a number of grouped Funds. The requirement is to provide the solution that works best and so at the outset, the project was not prescriptive regarding numbers and groupings which could be seen as limiting the options for consideration.

4. An option based on one all Wales LGPS Fund.

The four options were assessed on the following criteria which would appear more extensive than those prescribed in the call for evidence.

a) Reducing costs and sustaining service
b) Improving front line service delivery
c) Delivering a timely and responsive service
d) Improving back office administrative consistency and efficiency of process
e) Achieving the most by appropriate collaboration
f) Improving the employee/pensioner experience
g) Comply with sound governance arrangements and stewardship controls.
h) Better information for better decisions

A number of recommendations were made in the report covering specific areas such as administration, governance, investment and transitional issues.
A key recommendation was that the 'as is' or no change option was not supported. Enhanced collaboration is an area where medium term savings can be optimised without having to merge pension funds or administering authorities, any merger would be complex whilst transition management is costly with a long lead in time. From an administrative perspective it was identified that potential savings from changing the current operational arrangements were not significant in relative terms when compared to groupings or a single entity.

A copy of the Welsh Local Government Pension Funds – Working Together Report which contains 23 key recommendations, is attached for information

Scheme Governance will be further enhanced and standardised by the National Pensions Board, who may issue benchmarking and service standards for each fund to meet and be measured against. This will facilitate meaningful and equitable comparisons to be undertaken.

Whilst it is recognised that the Minister may wish to implement LGPS structural changes prior to the end of the current Parliament, excessive haste on scheme merger without full and accurate data analysis is unlikely to produce the best long term outcomes.

For ease of reference I have replicated the questions posed in the 'Call for Evidence'.

<u>Question 1</u> – 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 LGPS is a good model for localism with democratic accountability. Funds have their own Pension Committees which are linked to the democratic process. The members of the Pension Committees are nominated by the Council of the administering authorities. Funds also hold annual meetings where representatives from each employing body, unions and employer representatives have the opportunity to discuss the Fund's performance. Reducing the number of pension funds would appear to be contrary to the Governments localism agenda. Links to local authorities who, in Wales, have a statutory duty to improve and provide best value which is translated across to Pension Funds may become disjointed and less responsive. There is already a strong ethos of value for money and efficiency in Local Government which is applied across Pension Funds.

A large quantity of the data which is used for comparison is sourced from annual reports, newsletters or other statutory scheme documentation from overseas, LGPS scheme specific data should be used for comparison. In order for a true 'like for like' comparison to be made rather than the current method utilised by many commentators on the LGPS. There are performance measurement companies who currently provide a useful comparative analysis of returns against benchmarks and peer group universes. A more appropriate method would be to compare funds of similar maturity or investment strategy. In order to ensure meaningful data is compared it may be appropriate that the National Pensions Board prescribes the data required for comparison taking into account commercial sensitivity with fees. Each pension fund may also have a different allocation for internal / specialist resources and internal / hands on investment management which would impact on costs. There is also a different assessment and view of risk between funds.

The Welsh Local Government Pension Funds – Working Together Report identified that the use of a collective investment vehicle would facilitate more bargaining power on fees in addition to the potential for greater diversification of asset classes and managers, this can be achieved without incurring the time and expense of merging funds.

<u>Question 2</u> – Are the high level objectives listed above those we should be focusing on and why? If not, what objectives should be the focus of reform and why? How should success against these objectives be measured?

The high level objectives should not be limited to managing deficits and increasing investment returns. Maintaining an attractive and affordable pension scheme should also be a high level objective to ensure continuing employer support whilst attracting a continual flow of new members. Cash flows are becoming more critical as pressures on staffing budgets continue. Managing the deficit and increasing the investment return are intrinsically linked i.e. an increase in investment returns would decrease the deficit marginally. However it must be noted that changes to and variations from the actuarial valuation assumptions have the greatest impact on deficits. Success of the proposed high level objectives could be measured by either the increase in returns or more pertinently, the decrease in the deficit and the subsequent effect on the local taxpayer.

I am sure the minister will be aware that the funding level and resultant surplus/deficit is calculated by the scheme actuary on a triennial basis. In order for a meaningful comparison of the surplus/deficit to be undertaken, the same assumptions need to be used by each actuarial firm as referred to above. The LGPS is the only public sector scheme which is funded and although most funds may be in deficit, the benefits are still substantially funded when compared to other public and private sector schemes.

An additional high level objective should be for the LGPS to continue to deliver good quality sustainable pensions in an efficient way. This objective and the two primary objectives can be achieved though collaborative working and the use of common investment vehicles.

Pension funds already produce annual reports which show the investment return for the fund. CLG will need to specify the content of LGPS Pension Fund reports if they wish to have further detail for analysis.

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

The results of the analysis work of the All Wales project concluded that an appropriate and responsive governance structure to drive and manage future collaboration initiatives would explore the potential in the longer term for consistent valuation and funding assumptions and standards and take advantage of joint procurement initiatives to help consistency and efficiencies.

There is evidence that there are potentially significant financial benefits of scale to be found from working collectively through a common investment approach. The results of analysis demonstrate a general statistical trend of higher investment returns when a larger amount of investment assets is grouped together and invested. There are however no guarantees of improved returns and it does not appear to require organisational change to benefit since enhanced collaboration would achieve the same goal in a quicker and less disruptive way than fund mergers.

The potential benefits are not a direct relationship with the size of a fund but rather the result of economies of scale that together with size allow improved governance and the potential for increased return with a combination of attributes that larger funds tend to have such as:

- More internal / specialist resources;
- More internal / hands on management;
- Greater diversification – asset classes, managers;
- More bargaining power on fees;
- More responsive governance structures and processes in place enabling speedy decision making.

In order to compare the deficit in each fund it would be necessary to prescribe the assumptions to be used. Increasing employer contribution rates purely to attain a 100% funding level would not meet the requirements of ensuring employer contribution rate stability and may also lead to employers not being able to fund the scheme during these austere times. Local accountability enables funds to balance risk and affordability for each employer whilst managing the deficit recovery.

Each fund must take into account the profile of its liabilities before determining its funding strategy. Funds may feel that their funding strategy meets the liability profile of the fund and it may not be appropriate to invest in an asset class which may have a potential higher return but also inherent risk. Utilising a common investment vehicle will enable smaller funds to benefit from economies of scales without having to merge funds.

It should be noted that merging a fund with a high funding level with another fund would not result in the decrease of the deficit in the lower funded fund.

<u>Question 4</u> – 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?

The secondary objectives are linked to the high level objectives. The secondary objectives are not standalone but are interrelated. The All Wales work concluded that the potential financial benefit through any change varies considerably with the smallest benefit in the administration area and increasing in size through joint procurement, combining investments to benefit the level of fund manager fees and larger investment mandates (via merger or a collective investment vehicle) potentially achieving better investment returns. This latter option could however be achieved in a less disruptive manner through a collective investment vehicle across existing structures as opposed to new and larger structures.

It has been noted that based on past performance, larger funds have achieved higher returns with lower levels of risk. However, the reasons for the higher performance needs to be fully understood and it does not necessarily follow that this is purely a consequence of the value of the fund but could be attributable to factors such as governance, management and culture. Further investigation needs to be undertaken in order to assess if the economies of scale decrease once an investment fund has breached a certain limit, for example £2bn.

Reviewing the secondary objectives individually, I would comment as follows:

1. To reduce investment fees

A common investment vehicle will assist in the reduction of fees. However, it should also be noted that funds that employ a minimal number of asset managers on a balanced basis tend to pay less fees than those that employ specialist managers.

2. To improve the flexibility of investment strategies

It is not so much the flexibility of investment strategies but to have non complex strategies that are in line with the actuarial valuation assumptions and results. It is essential that there is a more collaborative and interactive relationship with external investment advisors to create the core beliefs that underpin the strategy. This would ensure that funds do not just buy into the latest trend or diversify unnecessarily. In establishing the strategy a fund will focus on return, risk or capital preservation.

3. To provide for greater investment in infrastructure

It is LGPS responsibility and a priority of Pension Funds to invest in assets that maximise investment return at appropriate risk and are seen as an effective diversification option. The LGPS should not be legislated or directed to invest in infrastructure, pension funds should consider the investment in infrastructure assets in the same manner as any other asset class basing its assessment on the comparative risk and return.

4. To improve the cost effectiveness of administration

It was identified from the Welsh Local Government Pension Funds – Working Together Report that scheme administration costs were not significant in relative terms to the other options considered, there was no substantial benefit to support groupings or a single entity being more cost effective than the current operational arrangements however, it was recognised that by further expanding on existing collaborative working initiatives, there would be benefits from cost reductions whilst meeting service requirements. Welsh pension funds have realised the benefits of working collaboratively on areas including scheme documentation, Annual Benefit Statements, Welsh language requirements and interpretation of regulations for many years. A move from the current operational arrangement may also result in the loss of high quality specialist staff which have to meet the demands of the most wide and diverse workforce in public sector with more challenging communication and pension awareness requirements. Sharing resources under collaborative working facilitates the retention of existing high quality staff resources. Many funds have already introduced interactive member facilities to reduce costs.

5. To provide access to higher quality staffing resources

Current staffing resources are of a high standard. Administration and investment staff have specific qualifications and continually keep up to date with new legislative changes and accounting requirements. The CIPFA Knowledge and Skills Framework is adopted by the funds and staff attend specific, relevant training courses, seminars and conferences. Further collaboration needs to occur between fund staff, investment advisors and consultants to share knowledge and experiences.

6. To provide more in-house investment resource

Funds have to be of sufficient size to make this resource cost-effective. The setting up of an in house investment management function is a large undertaking, requiring considerable resources and support from the administering authority. Internally managed funds are genuinely long term investors, independent advisors tend to be collaborative and the investment team and administering authority interest are aligned. For this, and many others reasons identified through the Working Together Report, the conclusion was that Welsh Funds should create collective investment vehicles which would provide the benefits of economies of scales whilst meeting localism requirements.

Secondary objectives which may be more appropriate to include in any assessment of the current and future structure could mirror those used in the Welsh Local Government Pension Funds – Working Together Report which are detailed below-

- Achieving the most by appropriate collaboration
- Reducing costs and sustaining service
- Improving front line service delivery
- Delivering a timely and responsive service
- Improving back office administrative consistency and efficiency of process
- Improving the employee/pensioner experience
- Complying with sound governance arrangements and stewardship controls.
- Better information for better decisions.

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?

Fund specific administration and investment performance data should be published. To mitigate the inherent difficulties of ensuring each fund measures the same data and also that funds comply with commercial sensitivity when releasing fees and performance data. National prescribed service standards should be issued thereby ensuring that a 'like for like' comparison of LGPS data is undertaken. Many of the current commentators use overseas data for analysis comparison rather than specific analysis of the LGPS. This was the case in the Hutton report on the review of the PSPS. There are performance measurement companies utilised who currently provide a useful comparative analysis of returns against benchmarks and peer group universes.

CLG would have to issue regulations stipulating the data to be measured and the methods and assumptions to be used. Each fund would be responsible for collating the data and if necessary, with the assistance of the scheme actuary, produce in the required format, this would be a similar process to the production of FRS17/IAS19 data. Each fund would have to ensure that the data provided is included in the annual report. It would be for the CLG to decide on how the data from each fund is to be collated for further analyses, e.g., it could be send directly to CLG,LGE or CIPFA for comparison with other LGPS funds. Whilst this a step towards monitoring service standards nationally, care must be taken to ensure that like for like assumptions and comparisons are made e.g. for investment return comparison, you cannot look solely at the fund return, it must be identified and recognised why an active or passive strategy was chosen and ensure like for like comparisons.

Finally, I would like to assure the Minister that Welsh Pension Funds are continuing to work collaboratively and are currently in the process of establishing a common investment vehicle as a result of the recommendation following the Welsh Local Government Pension Funds – Working Together Report, whilst also exploring other opportunities for collaborative working.

If you require clarification or further information on any of the aforementioned points, do not hesitate to contact myself or Mr. Chris Moore, Head of Financial Services on 01267 224160.

Yours sincerely,

R Jones
<u>Director of Resources.</u>