Introduction

The North Yorkshire Pension Fund (NYPF) recognises the challenge facing the LGPS of providing for good quality pensions that are sustainable and affordable by the taxpayer. A number of issues including challenging economic factors and changes in demographics have contributed to the future structure of the LGPS and this Call for Evidence. NYPF welcomes the opportunity to respond.

Objectives

It is important to start with the high level objectives. Rather than focus specifically on deficits NYPF believes the primary objectives should be:

1. To improve the effectiveness of investment decision making to achieve better returns relative to risk, and to lower investment costs

2. To improve the quality and cost of scheme administration

3. To enhance the accountability and transparency of the LGPS through better governance

Local contribution rates, funding levels, unit costs per member, investment performance results net of fees, and total expense ratios can be used as success criteria. Any analysis should be based on good comparative data as referred to below.

Objectives two and three are being addressed through the Pensions Act 2013 and the associated consultation exercise so our comments are primarily on the first objective.

Costs, efficiency and investment returns

Many comparisons have already been made between Funds particularly on the costs of administration and investment management. Although some of these comparisons have concluded that there is a clear relationship between size and efficiency, others have not. It is widely accepted that available data on LGPS Funds is of questionable quality as it contains significant inconsistencies. For example, investment manager fees will vary significantly but comparisons are almost always made between Funds without reference to the performance of those investments, how they compare with industry norms, or that performance fees distort comparisons over short time periods. However, currently available data does have some value and conclusions on the analyses are a good place to start.

Looking at the SF3 statistics collected by DCLG, the latest set of data available is for the financial year 2011/12 and is attached as Appendix 1. We have used this data to produce two scatter graphs, the first being a comparison of fund membership to administration costs per member, the second a comparison of membership to costs including investment management fees. We believe that 3 broad conclusions can be drawn – firstly funds achieve a level of efficiency once they reach approximately 30,000 members; secondly that the increased efficiency of much larger funds is relatively marginal thereafter; and thirdly that most funds with membership under 30,000 appear to have scope to significantly improve efficiency. It is also helpful for us to see the position of NYPF.

LGPS data on investment management costs includes Funds that use external managers only, those that manage all of their investments internally, and others that have a mixture of both. This will clearly have a significant effect on costs as in-house investment is cheaper to carry out. Each Fund will also have a different investment strategy depending upon their current funding levels and whether or not that results in a more active pursuit of high returns or a more passive approach of mirroring liabilities.

The more appropriate primary objective described above is "to improve the effectiveness of investment decision making to achieve better returns relative to risk, and to lower investment costs". All LGPS Funds will recognise the push to become more efficient, and the investment strategy of each Fund should be the driver for decisions on internal or external, and passive or active management.

An example of one piece of research which looked into investment management fees, including the reasons for differences in cost, is that produced by the world's leading independent benchmarking company CEM Benchmarking Inc which compared LGPS funds with their international peers. The main findings were:

- LGPS funds pay similar investment management fees to comparable funds 10 times the size, demonstrating that funds have been effective in negotiating fees, weakening the argument for mergers
- Additional fees were paid to access investments through the fund of funds route, particularly in relation to property, infrastructure and private equity, which suggests that collaboration between LGPS funds through pooling assets could achieve efficiencies in some areas

It may therefore be overly simplistic to assume that merging funds into a single investment strategy will necessarily be both more efficient and lead to higher returns. What this evidence points to is the need for much greater clarity on data to allow for more robust conclusions. To achieve this, CIPFA would be an appropriate body to set a standard for the analysis of data requirements to allow more meaningful comparisons, with funds obligated to provide comprehensive data on a strict schedule.

North Yorkshire Pension Fund recognises that the challenges ahead are such that there is a need to identify efficiencies wherever possible and to drive up investment performance and funding levels accordingly. North Yorkshire County Council is one of 38 members of the Society of County Treasurers working on a collaborative approach to investment management procurement. This will allow members to retain local decision making while benefiting from the economies of scale of lower fees from an aggregated value of investments. Framework agreements covering consultancy, actuarial services and legal services are already available and are evaluated by NYPF at each procurement event.

The Call for Evidence identified infrastructure as an asset class, as a secondary objective. NYPF believes that a focus on one asset class should not take precedence over the overall fiduciary management of the scheme. Infrastructure should be evaluated alongside opportunities in relation to other asset classes, as appropriate to each investment strategy.

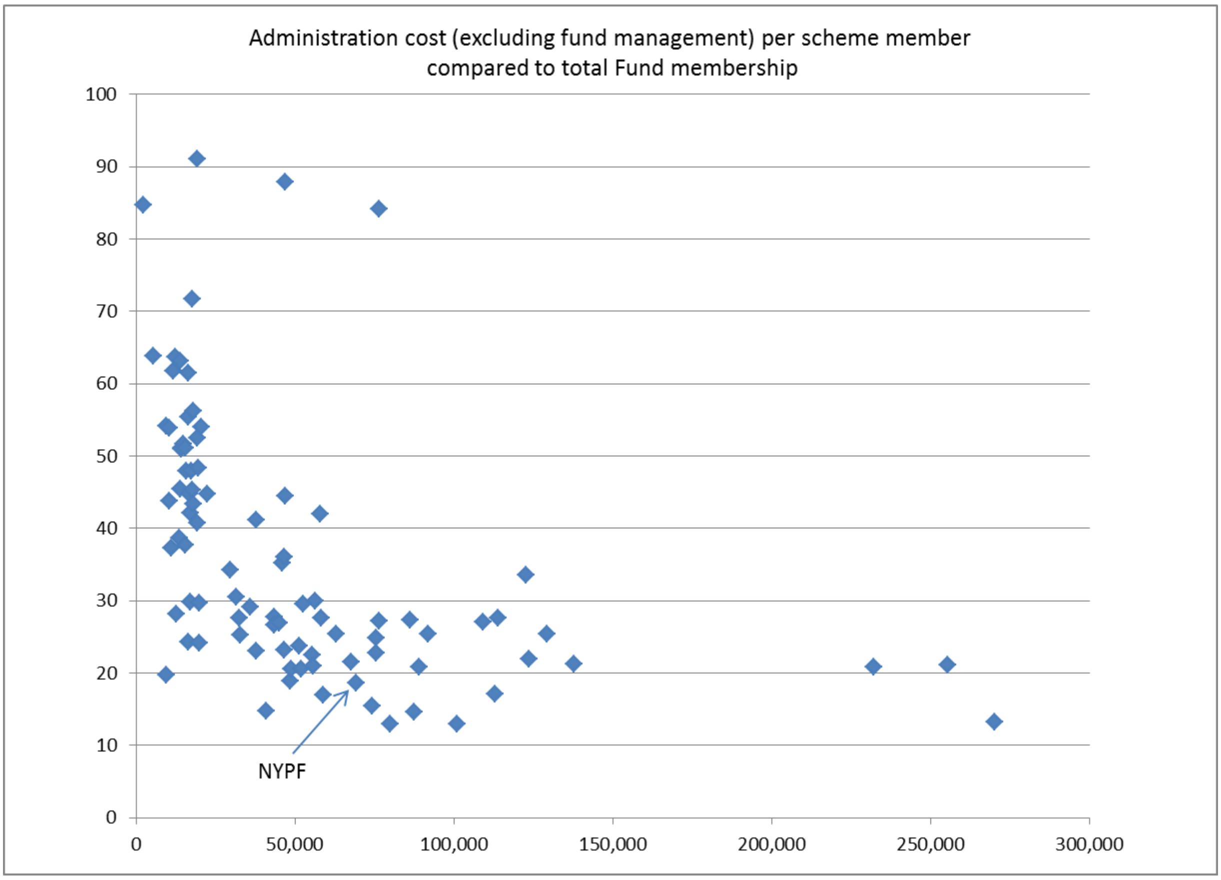
Governance and accountability

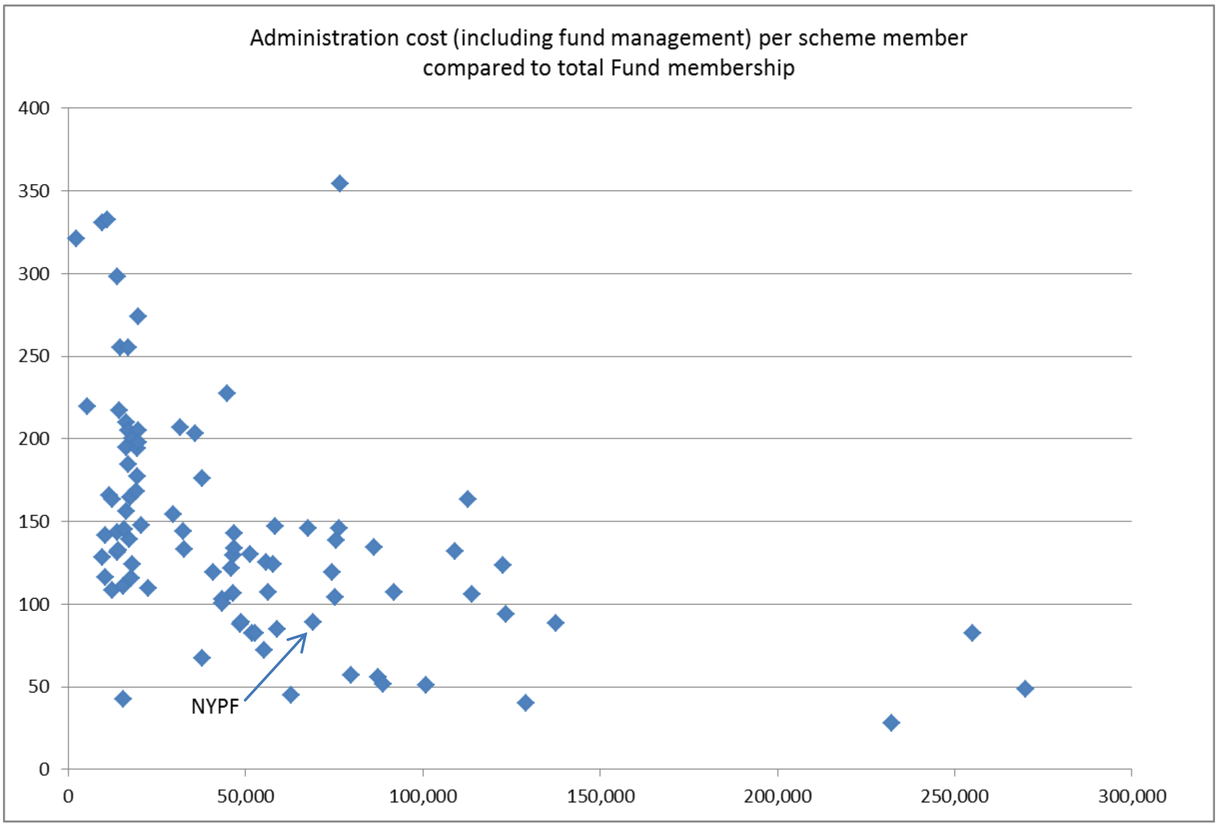
We believe that accountability to local taxpayers and other interested parties is best maintained by retaining the link between the Pension Fund and the local authorities. Local Government Pension Funds are well versed in ensuring appropriate governance which runs through elections, decision making, reporting and being accountable to a wide range of stakeholders. The current arrangements ensure that there is a keen interest in the performance and governance of the Local Pension Fund which would be at risk in the event of larger funds where there is less local affinity.

There is also a real practical difficulty in ensuring accountability to local tax payers whilst bringing together separate Pension Funds with different funding levels. Any approach towards equalisation will have winners and losers. Any perceived benefits in terms of mergers would be at risk of being outdone by the administrative overhead of seeking to segregate funding levels from constituent parts should equalisation not take place.

If the primary interest is to strengthen accountability to local tax payers and other interested parties then we strongly believe that there is a need to preserve the local ownership of the Pension Fund whilst seeking ways to collaboratively reduce the costs and improve the performance of investments. Imminent changes in the governance of the Pension Fund, if managed well, should help to consolidate this position by enhancing accountability and transparency.

Appendix 1


Administration cost (excluding fund management) per scheme member
compared to total Fund membership
100
90
80
70
60
50
40
30
20
10
0
0
50,000
100,000
150,000
200,000
250,000
300,000
NYPF


Administration cost (including fund management) per scheme member
compared to total Fund membership
400
350
300
250
200
150
100
50
0
0
50,000
100,000
150,000
200,000
250,000
300,000
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