APPENDIX 2

BRIEFING NOTE

LGPS INVESTING

Introduction

In his June budget the Chancellor of the Exchequer said:

"Local Government Pension Scheme pooled investments – The government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments".

This is the latest in a series of attempts by Government to achieve some change in the LGPS investment world starting with the Call for Evidence in 2013. These include proposals for:

- The amalgamation of the existing funds into 5.
- Complusory investment in infrastructure.
- Compulsory use of passive management

Each of these initiatives fizzled out achieving nothing. Whilst clearly the LGPS has to be transparent and accountable for the actions it takes there are significant downsides to the latest CLG ideas.

Current Position

There are 89 funds in England and Wales managing around £180bn – so an average £2bn each. There is actually a large variation in size:

- Ex Metropolitan counties eg Greater Manchester, West Yorkshire, West Midlands- at around £10bn.
- County funds of which Kent £4bn would be one of the largest. The county funds probably account for 50-60% of total assets.
- 32 London Borough funds typically less than £1bn.

No fund is 100% funded and all face reduced cash flows as local authority budgets and workforce reduce dramatically because of deficit reduction.

It is important to be clear that the funds only exist to pay current and future pensions. The local pension committees of the administering authorities have a pseudo trustee role in relation to the management of monies placed in the fund by employees and employers.

The Investment Regulations set by the Department of Communities and Local Government give very substantial freedoms to funds to invest as they wish and there is no real central monitoring of their activities. Management of the fund takes varying priority within Councils- there are serious issues of capability in some places. This is epitomized by the London Boroughs who collectively manage £30bn but do so through an amazing 90 managers with 300 separate mandates. The creation of a Collective Investment Vehicle to pool investments will address this but it has taken three years to get to where they are and it is still not fully implemented.

Facts

There is much publically available information from independent sources about just how well the LGPS is managed. For instance:

- 20 year return of 8% per annum compared with inflation of 3%.
- 3 year return of 11% against inflation of 2%.
- These funds are in general performing well..
- Average investment fees of 0.41%-less than the comparative cost in the corporate pension world.
- Kent pays an average fee rate of 0.3%.
- On average funds are not overpaying for investment managers fees.

An analysis presented by Hymans Robertson in 2014 showed that net of investment manager fees only one third of funds had added value over the benchmark return. It is also clear that there are a set of consistently under performing funds and something does need to be done about them.

CLG Proposals

Officers have been selectively invited by the LGA pensions lead officer to roundtable discussions with CLG officials. Whilst CLG are reluctant to commit to anything they seem to want to create 5 large pools of assets, individual funds will remain and decide what assets to invest in but they will have no choice of investment managers.

Whilst some pooling of assets makes sense there are important asset classes such as direct property where it makes no investment sense at all. It is a very centralized solution and it would take away the innovation which many County funds bring to this work with exemplars of best practice based on local decision making.

There now seem to be a plethora of Officer working groups looking to see how the CLG objectives can be met but without challenging the underlying sense of what is being proposed. There has to date been limited member engagement.

Issues with the CLG proposals

The proposals seem to reflect little understanding of how LGPS investing works. The main issues are:

- Many funds have well established and highly successful investment management arrangements at a very modest cost. The changes proposed could easily mean investment management costs going up.
- Changing asset allocation and investment managers is a very expensive business and will cost hundreds of millions of pounds to achieve and take years to implement.
- There is no evidence that these larger pools are the best way forward-or better than what happens now.
- With strong market returns in recent years funds are getting ever closer to 100% funding levels. As that happens they will need to change asset allocation to hold more bonds to match liabilities. So if these pools are created at great cost they may well have to change yet again.
- The proposals do nothing to address the underperforming funds. They could be targeted for action such as making them hold more assets passively, or restricting the number of investment managers they can have, or partnership arrangements with other funds.
- They completely cut across the fiduciary responsibilities of local pension committees.
- Funds have been making big cost savings through collaborative procurements led by the Norfolk pension Fund.

Timescales

It is understood that CLG will be looking to brief ministers in late October with a view to some announcements after that and then they will consider detailed proposals in the spring.

What we should do

A more considered approach would be:

- Be absolutely clear what you want administering authorities to achieve and let them get on and deliver it rather than try to impose some ill conceived centralist solution devised by people who don’t understand the business.
- If fees are the main issue impose a cost cap on funds- so in total their fees should not exceed a certain level say 0.5%.

- Focus on under performing funds- they could be mentored by better performing funds. Each fund is subject to its own external audit and this could focus more on performance and governance issues.
- Address the London issue- this is already happening through the Collective Investment Vehicle but there are still 32 separate authorities making asset allocation decisions and that’s too many.
- More collaborative procurement of manager through frameworks- funds are looking at a framework contract for the £50bn of passively managed equities.