

**SOUTH YORKSHIRE
PENSIONS AUTHORITY**

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Financial Conduct Authority

Diana Terris
Clerk

18 Regent Street
Barnsley
South Yorkshire
S70 2HG

www.southyorks.gov.uk

NOTICE OF ORDINARY AUTHORITY MEETING

You are hereby summoned to the Ordinary meeting of South Yorkshire Pensions Authority to be held at the offices of the South Yorkshire Joint Secretariat, 18 Regent Street, Barnsley on Thursday 19 June 2014 at 10.15 am for the purpose of transacting the business set out in the agenda.

M Jaworski
Deputy Treasurer

This Matter is being dealt with by: Gill Garrety

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Distribution

Councillors R Wraith (Vice-Chair), E Butler, J Campbell, S Ellis, R Ford, B Lodge, K Rodgers, L Rooney, A Sangar, M Stowe, P Wootton and B Webster

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SOUTH YORKSHIRE PENSIONS AUTHORITY

ORDINARY MEETING

19 JUNE 2014 AT 10.15 AM AT THE OFFICES OF THE SOUTH YORKSHIRE JOINT SECRETARIAT, 18 REGENT STREET, BARNSELY

Agenda: Reports attached unless stated otherwise

	Item	Page
1	Apologies	
2	Announcements	
3	Urgent Items To determine whether there are any additional items of business which by reason of special circumstances the Chair is of the opinion should be considered at the meeting; the reason(s) for such urgency to be stated.	
4	Items to be considered in the absence of the public and press. To identify items where resolutions may be moved to exclude the public and press. (For items marked * the public and press may be excluded from the meeting).	
5	Declarations of Interest.	
6	Presentation of Loyalty Awards	Verbal Report
7	Minutes of the Authority meeting held on 20 March 2014	1 - 8
8	Work Programme	9 - 10
9	Section 41 Feedback from District Councils	Verbal Report
10	Performance Snapshot Report 2013/14: Quarter 4	11 - 16

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12	LGPS Reform Proposals Update	Verbal Report
13	Discretionary Pension Policies	17 - 20
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16	Transforming Rehabilitation Programme and the LGPS	211 - 212
17	Webcasting	213 - 214
18	Co-op Bank Update	Verbal Report
19	Referendum on Scottish Independence	215 - 218
20	South Yorkshire Pension Fund Annual General Meeting 2014	219 - 220
21	Member Development Annual Update	221 - 248
22	<u>Exclusion of Public and Press</u>	
*23	Staff Establishment: Additional Post (Exemption Paragraph 1, 2)	249 - 252

SOUTH YORKSHIRE PENSIONS AUTHORITY

20 MARCH 2014

PRESENT: Councillor K Goulty (Chair)
Councillor R Wraith (Vice-Chair)
Councillors: D Baker, J Campbell, M Lawton, K Rodgers,
L Rooney, A Sangar and P Wootton

Trade Unions: G Boyington (Unison), G Warwick (GMB) and
F Tyas (UCATT)

Officers: S Pick, G Chapman (Head of Pensions
Administration), J Hattersley (Fund Director) and M McCoolle
(Senior Democratic Services Officer)

G Kirk (BMBC), J Bell (Barnsley MBC) and I Rooth (BMBC)

Apologies for absence were received from Councillor E Butler,
Councillor B Ford and Councillor K Richardson

1 APOLOGIES

Apologies for absence were noted as above.

2 ANNOUNCEMENTS

None.

3 URGENT ITEMS

An urgent report entitled 'Attendance of Member at Meetings', would be taken as Item 24, in the absence of the public press.

4 ITEMS TO BE CONSIDERED IN THE ABSENCE OF THE PUBLIC AND PRESS

RESOLVED – That the following agenda items be considered in the absence of the public and press:-

Item 22 'Debt Write Offs'

Item 23 'Release of Preserved Benefits – Compassionate Grounds'

Item 24 'Attendance of Member at Meetings'

5 DECLARATIONS OF INTEREST

None.

6 MINUTES OF THE AUTHORITY MEETING HELD ON 16 JANUARY 2014

RESOLVED – That the minutes of the Authority meeting held on 16 January 2014 be signed by the Chair as a correct record.

7 MINUTES OF THE AUTHORITY MEETING HELD ON 13 FEBRUARY 2014

Councillor Sangar queried whether dialogue with the actuary and the district councils was on-going.

The Fund Director had raised the matter with the South Yorkshire Treasurers' Association, and had said we wanted to improve liaison with the actuary to at least a 6 monthly basis. The meetings would be minuted and presented at the next available Authority meeting; Mercers had agreed to this in principle. A response was awaited from SYTA.

RESOLVED – That the minutes of the Authority meeting held on 13 February 2014 be signed by the Chair as a correct record.

8 WORK PROGRAMME

The Authority considered its' Work Programme to 12 June 2014.

Members noted the proposal to reschedule the AGM from 12 June 2014 to 19 June 2014, due to the Local and European elections on 22 May 2014; the matter would be discussed later on the agenda.

RESOLVED – That the contents of the Work Programme be noted.

9 SECTION 41 FEEDBACK FROM DISTRICT COUNCILS

Councillor Lawton was still receiving a number of queries regarding social investment issues, and from councillors regarding the changes to councillors' pensions. Councillor Lawton requested the Head of Pensions Administration to write a paper to provide councillors with generic information and advice upon coming out of the scheme.

The Head of Pensions Administration agreed to the request, and added the end of term office dates for every councillor in the scheme had started to be collated, to allow him to personally write to them to explain the options available.

10 PERFORMANCE SNAPSHOT REPORT 2013/14: Q3

A performance snapshot report for 2013/14: Q3 was submitted for Members' information.

During the quarter there had been two redundancy retirements, one leaver and one new starter; staff training continued to be up to date. Sickness absence was 2.8% in total, which was 0.3% down on the previous quarter.

There had been 19 new employers registered for EPIC during the quarter, and 265 new members had registered for MyPension.

RESOLVED – That the report be noted.

11 TREASURY MANAGEMENT STRATEGY STATEMENT 2014/15

A report of the Clerk and Treasurer was submitted to seek Members' approval of the treasury management procedures and strategy followed by the Authority.

RESOLVED – That the Authority:-

- i) Adopted the Annual Investment Strategy and recommendations set out in Appendix I to the report.
- ii) In accordance with Section 3(1) of the Local Government Act 2003 approved an Affordable Borrowing Limit, on a rolling basis for the forthcoming year and two successive years as outlined in Appendix II, of £250,000 being the maximum amount the Authority could afford to borrow.
- iii) Keep the above under review.

12 REVISED FUNDING STRATEGY

A report of the Head of Pensions Administration was submitted to seek Members' confirmation of changes to the funding strategy.

RESOLVED – That Members confirmed the changes to the funding strategy.

13 2013 TRIENNIAL VALUATION UPDATE

A report of the Head of Pensions Administration was submitted, which advised Members of the final outcome of the 2013 Triennial Valuation exercise.

At the last Authority meeting the actuary had updated Members on the results of the 2013 valuation exercise, which revealed a national deficit of £1,704m representing a funding level of 76%, and an average employer's future accrual contribution rate of 12.8%.

Members noted that the valuation would be completed on time by 31 March 2014; all employers had been notified of contribution rates and reminders had been issued to deduct the correct amounts from April 2014.

Councillor Lawton gave thanks on behalf of Members to all officers and Mercers for the hard work undertaken during the last year, and requested thanks be forwarded onto all staff involved.

RESOLVED – That the report be noted.

14 BOARD CHAIRS' REPORTS

Councillor Gouly reported that the Authority had won two performance awards for the Segregated Pension Funds and the 10 Year Relative Return Award, for the IPD/IPF Property Investment Awards for 2014, which the Authority had also won last year. The Award Ceremony recognised the highest 3 year return performance within 13 categories based upon the fund type and size, and top risk adjusted returns over the 10 year period to December 2013. The Authority had won the 10 year award as well

as the 3 year category, which the Authority had won for the last 2 years. Congratulations were given to the officers involved.

Councillor Lawton would step down from the Authority as of today, and Members thanked him for his assistance and dedication to the Authority in both his roles of Chair and Member. Councillor Sangar added that Councillor Lawton had continued to attend conferences, read information on other investments that the Authority should take an interest in, and provided challenge to officers.

15 MANAGEMENT ARRANGEMENTS AND OPERATING AGREEMENT BETWEEN BARNSELY METROPOLITAN COUNCIL AND SOUTH YORKSHIRE JOINT SECRETARIAT

A report of the Clerk and Treasurer was submitted to advise the Authority of the proposals for alterations to the senior management arrangements within Barnsley Council to support the South Yorkshire Joint Secretariat, and to seek approval to the necessary amendment of the existing Operating Agreement between the Council and the Joint Authority to reflect these changes.

The Director of Human Resources BMBC commented that there were no proposals to change staff structures, other than being structured with BMBC colleagues.

Members requested to be kept updated, and hoped this would not impact upon the service provided to the Authority.

Councillor Rodgers had a misgiving about the current SYJS administrative function becoming part of BMBC.

Members expressed their appreciation for the contributions over the years that the retiring officers (Steve Pick as Clerk and Treasurer and Maureen Oades as Deputy Clerk, Solicitor and Monitoring Officer) had made to the successful management of the Authority.

RESOLVED – That:-

- i) The Authority approved appropriate alterations to the existing Agreement with Barnsley Council.
- ii) The Chief Executive of Barnsley Council be appointed Clerk to the Authority with effect from 1 April 2014.
- iii) The Director of Finance, Property and Information Services of Barnsley Council be appointed Proper Officer for administration of the Financial Affairs of the Authority pursuant to Section 73 of the Local Government Act 1985 with effect from 1 April 2014 with the title Treasurer.
- iv) The Director of Legal and Governance of Barnsley Council be appointed Monitoring Officer and solicitor to the Authority with effect from 1 April 2014.
- v) Appropriate amendments be made to the Scheme of Delegation of the Authority in respect of functions presently delegated to the Clerk and Treasurer.

16 LGPS REFORM PROPOSALS UPDATE

The Head of Pensions Administration provided Members with an update on the LGPS Reform.

Members noted the Transitional Regulations had finally been received, and would allow the Authority to finalise arrangements.

A newsletter would be sent to scheme members before 31 March 2014, which would welcome them to the new scheme, provide useful information i.e. the new 50/50 section, and encourage people to take an interest in their pensions. In an attempt to encourage more scheme members to read the newsletters three different designs were being issued based around different age groups.

Emails had been sent to councillors as soon as the information was received that councillor membership would cease at the end of the current term of office for each councillor. Councillors would receive written information to explain the short term position, and again when their term of office came up, to explain the benefits available to them.

The Head of Pensions Administration reported that the Governance Draft Regulations were expected during April 2014, and would be sent out to Members

Following various submissions and the study undertaken by Hymans, the Minister had intimated that he may be moving away from the idea of fund mergers and considering exploring the possibility of fund collaboration via common investment vehicles etc. Papers would shortly be made available.

The Head of Pensions Administration commented that following the results of a recent survey the DfE were rumoured to be less interested in the idea of pooling academies.

RESOLVED – That the update be received.

17 TRADES UNION REPRESENTATION ON BOARDS

A report of the Clerk and Treasurer was submitted to inform the Authority of the current position regarding Trades Union seats on the Corporate Planning and Governance Board and the Investment Board.

Members noted that Trades Union representatives had three seats allocated to each Board.

RESOLVED – That Members approved the extension to the Terms of Office of the Trades Union representatives on the Authority's Boards until implementation of new governance arrangements or 31 March 2015, whichever was the earlier.

18 MEETINGS OF THE AUTHORITY AND BOARDS IN 2014/15

A report of the Clerk and Treasurer was submitted to consider the proposed schedule of Authority and Board meetings during 2014/15.

Pensions Authority: Thursday 20 March 2014

As a result of the Local and European elections on 22 May 2014, Members noted the proposal to reschedule the AGM from 12 June 2014 to 19 June 2014.

A meeting of the Corporate Planning and Governance Board was required in late July 2014 to approve the Accounts and Annual Report. A meeting was proposed for Thursday 24 July 2014 at **2.00 pm**, to avoid a clash with a BMBC meeting.

Members noted the following cycle of meetings for 2014/15:-

Pensions Authority	Corporate Planning & Governance Board	Investment Board	PAP
	2014		
19 June (Annual)	19 June*	26 June* ¹	
			8 July*
	24 July @ 2pm		
		18 September	
2 October			
			14 October
	13 November		
27 November			
		11 December	
	2015		
15 January			20 January
		12 March	
19 March	19 March		
			14 April**
11 June** (Annual)	18 June**	25 June**	
			7 July**

* Meeting dates already approved

¹ Moved from May due to elections

** Dependent on new governance arrangements

RESOLVED – That Members approved the cycle of meetings for 2014/15.

19 MEMBER TRAINING AND EDUCATION: EXTERNAL CONFERENCE

A report of the Clerk and Treasurer was submitted to bring to Members' attention the LGA Trustees Annual Conference.

Members noted the eleventh annual trustees' conference would be held at the Marriott Highcliff Hotel, Bournemouth on 19 and 20 June 2014. Members were advised to contact G Garrey on 01226 772806 if they wished to enrol.

RESOLVED – That Members considered whether or not they wished to register for the conference.

20 UPDATE ON THE CO-OPERATIVE BANK

The Clerk and Treasurer was unaware of any significant changes since last reported, and would keep Members updated. The Fund Director was undertaking market testing, and it was possible that the Authority could move to a new bank by the late summer.

RESOLVED – That the update be noted.

21 SOUTH YORKSHIRE COMBINED AUTHORITY: THE BARNESLEY, DONCASTER, ROTHERHAM AND SHEFFIELD COMBINED AUTHORITY ORDER 2014

A report of the Fund Director was submitted to update Members on the Government's consultation over a proposal to replace the South Yorkshire Integrated Transport Authority with a combined authority and the implications for its responsibilities as an administering authority of the Local Government Pension Scheme (i.e. the South Yorkshire Passenger Transport Pension Fund). It was expected that the CA would come into existence on 1 April 2014 and that all existing contracts, including those with this Authority, would transfer to the new authority.

RESOLVED – That Members noted the report.

22 EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED – That, under Section 100A(4) of the Local Government Act 1972, the public be excluded from the meeting for the following item of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act and the public interest not to disclose information outweighs the public interest in disclosing it.

23 DEBT WRITE OFFS

A report of the Clerk and Treasurer was submitted, to authorise the write-off of outstanding rent accounts relating to the Fund's commercial property portfolio.

RESOLVED – That Members authorised the write-off of outstanding rent accounts relating to the Fund's commercial property portfolio, as detailed in the report.

24 RELEASE OF PRESERVED BENEFITS - COMPASSIONATE GROUNDS

A report of the Head of Pensions Administration was submitted to seek a decision from Members in relation to a request from a former Barnsley Development Association employee for the release of preserved benefits on compassionate grounds.

RESOLVED – That Members:-

- i) Reviewed the circumstances surrounding the request for release of preserved benefits as attached at Appendix A to the report.

- ii) Agreed to release the preserved benefits on compassionate grounds.

25 ATTENDANCE OF MEMBER AT MEETINGS

A report of the Clerk and Treasurer was submitted for Members to consider the non-attendance at meetings of a member of the Authority, due to mitigating circumstances, and the options open to the Authority.

RESOLVED – That Members agreed the Member would remain on the Authority until the AGM.

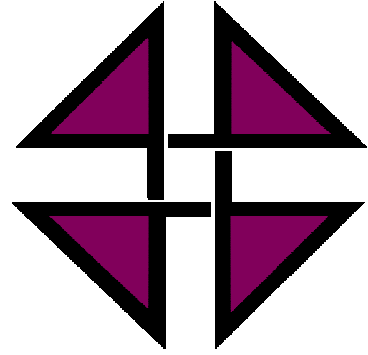
CHAIR

South Yorkshire Pensions Authority – cycle of future meetings

Authority Meetings

Agendas	19 June 2014 AGM	19 June 2014 Ordinary Meeting	2 October 2014	27 November 2014
Strategic Overview of Business		Meeting Overview & Context		Meeting Overview & Context
		S41 Feedback		S41 Feedback
Board Scrutiny		Call-Ins		Call-Ins
Review of Strategies		Qtr 4 Performance Snapshot Report	Qtr 1 Performance Snapshot Report	Qtr 2 Performance Snapshot Report
			Annual Review of Risk Management Policy	
			CPGB Audit Committee Functions Annual Report	Budgets and Revised Estimates
Business	Appointment of Chair and Vice Chair	Board Chairs' Reports	Board Chairs' Reports	Board Chairs' Reports
	Membership of the Authority	Loyalty Awards	LGPS Reform Proposals Update	LGPS Reform Proposals Update
	Appointment of Boards and Committees	LGPS Reform Proposals Update (verbal)	FoIA Annual Report/ Publication Scheme	SYPF Annual Fund Meeting Report
	Questions in Meetings of District Councils	LGPS 2014 Discretionary Policies	SYJS transition employment/budget implications etc	

	19 June 2014 AGM	19 June 2014 Ordinary Meeting	2 October 2014	27 November 2014
Business		LGPS Consultation on collaboration and cost savings	LGA QC Fiduciary Duty	
		Members Self-Assessment Report		
		Probation Transfer		
		Webcasting		
		Co-op Bank Update (verbal)		
		Scheme of Delegation		
		Contract Standing Orders		
		Scottish Independence		
		Annual Fund Meeting		
		Staff Establishment: Additional Post		
Training & Development		Member Development Annual Update	LGPS New Scheme (GC)	



SOUTH YORKSHIRE PENSIONS AUTHORITY

Business Planning and
Performance Framework 2013/14
for the Pensions Service
and Pensions Authority

**Performance Snapshot Report
2013/14: Q4**

ISSUED: June 2014

The strategic framework in outline

Pensions Service Strategic Objectives	Area of Impact
1: The Best	1.1: Engaging with all our partners, including employers, to ensure that we understand and meet their agreed needs 1.2: Providing an accurate and timely service to all customers 1.3: Gaining and retaining external recognition through quality standards awards such as Charter Mark and Customer Service Excellence 1.4: Ensuring that we continue to provide Value for Money
2: Investment returns	2.1: Monitoring performance against the adopted benchmark and targets
3: Responsible Investment	3.1: Developing and implementing a responsible investment policy that is compatible with the fiduciary duties of the Fund 3.2: Adopting a voting strategy and guidelines specific to the Fund's requirements and ensuring that it is regularly reviewed in accordance with industry best practice
4: Valuing our Employees	4.1: Maintaining a competent, valued and motivated workforce. 4.2: Encouraging personal development to improve knowledge, skills and effectiveness.
5: Pensions Planning	5.1: Providing information through written material to all customers 5.2: Developing interactive website facilities 5.3: Encouraging attendance at annual events to provide forums for discussion 5.4: Maintaining an "on-site" presence to address personal concerns
6: Effective and Transparent Corporate Governance	6.1: Clarifying functions and roles towards delivering a common purpose 6.2: Promoting good governance through upholding high standards of conduct and behaviour 6.3: Developing the capacity and capability of members and officers to be effective 6.4: Ensuring robust accountability

Snapshot performance results for each Strategic Objective and Area of Impact appear on the following pages

Pensions Service Strategic Objectives

1. The Best

Area under Review	Activity During Quarter	Target	Status/Comment
Transactions with Members	15,003 cases of which 99.7% were on target	97%	Performance consistent with the previous quarter.

2. Investment Returns

Area under Review		Target	Status/Comment
Fund Value	£5519.2m	N/A	£5472.7m at end Dec
Performance Against Benchmarks	Qtr 1.0% YTD 5.7%	Qtr 1.2% YTD 5.4%	Global economy appears to be on a path of slow steady growth. Emerging markets continue to underperform developed markets. Bonds still look relatively expensive.

3. Responsible Investment

Area under Review	Activity During Quarter	Target	Status/Comment
Responsible Investment		-	Ongoing

4. Valuing Our Employees

Area under Review	Activity During	Target	Status/Comment
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Quarter			
Staff Turnover	1 Redundancy Retirement 1 New Starter	Annual 4.25%	Target Achieved
Staff Training	Customer Service Refresher – All Staff SharePoint Advanced Training - IT	Plan 100% up to date	On target
Sickness Monitoring	- 1.5% total	None	Down 1.3% on previous quarter.

5. Pensions Planning

Area under Review	Activity During Quarter	Target	Status/Comment
Interactive Facilities	22 new employers registered for EPIC 79% of registered employers who submitted information did so via EPIC 597 new members registered for MyPension	N/A	253 employers (95%) now registered for EPIC. Non-Epic employers only represent 49 active members Solution now in place for payroll providers to represent multiple employers. Small number of forms issued via post. 597 Members now registered in total.
Face to Face Communication	Advisory Sessions Held	Less than 0.5% complaints	No complaints received. 267 more appointments than the previous quarter.
Employer Activity	13 New Employers	N/A	At the end of March 2014 we

(12 Academies, 1 Transferee Admission Body)	had 344 participating employers of which 276 had active members and there are a further 80 in the pipeline.
0 Terminations	

Pensions Authority Strategic Objectives

6. Effective & Transparent Corporate Governance

Area under Review	Activity During Quarter	Target	Status/Comment
Internal Audit Annual and Quarterly Reports	<p>March – Internal Audit Progress Report reviewed by CP&GB</p> <p>March – Internal Audit Annual Plan considered by CP&GB</p> <p>March – Internal Audit Charter and Strategy considered by CP&GB</p>	100%	On target
External Audit Reports /Plans	March – KPMG External Audit Annual Plan considered by CP&GB	100%	On target
Risk Management Annual and Quarterly Reports	March - Risk Register considered by CP&GB	100%	On target
Constitution Policy /Procedure Revision Dates	No updated reported	100% Up to date	
Financial Reporting	Budget Monitoring report – Quarter 3 considered by	100% achievement of reporting	On target.

Area under Review	Activity During Quarter	Target	Status/Comment
	CP&GB	schedule	
Annual Governance Statement Conclusion		No Significant Weaknesses	Accuracy of pay and contributions identified. Action continuing.
Annual Self-Assessment	No update reported		
Member Training		100% Induction & Fundamentals Training & Fundamentals Refresher	<p>100% had induction.</p> <p>92% had Fundamentals Day 1.</p> <p>83% had Fundamentals. Day 2.</p> <p>67% had Fundamentals Day 3.</p> <p>58% had Fundamentals Refresher Training</p>

SOUTH YORKSHIRE PENSIONS AUTHORITY

19th June 2014

Discretionary Pension Policies

1. Purpose of the Report

To implement the authority's policies on the discretionary areas of the LGPS

2. Recommendations

Members are recommended consider the contents of the report adopt the updated polices required by LGPS 2014

3. Background

- 3.1 All Local Government Pension Scheme employers are required by the 2014 Local Government Pension Scheme Regulations to publish their policies in relation to how they will exercise the discretionary powers that are available to them.
- 3.2 In addition to being an administering authority for the purposes of the scheme regulations, South Yorkshire Pensions Authority is also a local government pension scheme employer and consequently must publish policies in the following areas,
- The funding of additional pension for a member either through regular contributions or by lump sum (Regulations 16(2)(e) & 16(4)(d))
 - Flexible Retirement (Regulation 30(6))
 - The waiving of the actuarial reduction in those cases where the member voluntarily retires early (Regulation 30(8))*
 - Switching on the 85 year rule for members voluntarily drawing benefits on or after age 55 and before age 60 (Schedule 2 of the Transitional Regulations)
 - The awarding of additional pension to a member (Regulation 31)

*The regulations also require administering authorities to exercise their discretion in this area on behalf of scheme employers who no longer exist.

4. Matters for consideration

- 4.1 The discretionary powers available must be used in a properly considered manner and in such a way as not to fetter any of the discretions available and in accordance with the following general principles:
- The application of a discretion needs to fit with the business aims and plans of the authority and must help or further those plans where appropriate
 - The application of a discretion should not give rise to a cost to the authority unless that cost can be met from any savings arising from the long-term use of the discretion in question and meets or supports the business aims or plans of the authority

- The authority recognises that the application of a discretion must be equitable in every case
- The application of a discretion must not be seen as a reward for a particular class or group of staff.
- Notwithstanding any of the above, each and every case or application will be considered on its individual merits.

5. The Discretionary Policies

DISCRETION	POLICY STATEMENT
<p>Funding of Additional Pension</p> <p><i>Regulations 16(2)(e) and/or 16(4)(d)</i></p>	<p>Because of the costs involved and the likelihood of this provision either being of little or no benefit to the authority, or not being vital to the support and application of the authority’s business plan and strategy, then the authority would not normally expect to exercise its discretion to fund additional pensions for members either through regular contributions or lump sum contributions. However, each and every application will be considered in the light of the circumstances of the individual case concerned and a decision reached on the merits of that case</p>
<p>Flexible Retirement</p> <p><i>Regulation 30(6)</i></p>	<p>The authority seeks to support the principle of allowing members to prepare for retirement in as many ways as possible. In this it also seeks to support Government Policy where that policy supports the authority in its efforts to run its business and services in the most efficient and cost effective manner. As such, subject to the following criteria, the authority would normally expect to exercise its discretion in allowing members to retire flexibly:</p> <ul style="list-style-type: none"> • Any reduction in working hours or salary must be permanent • Any reduction in working hours or salary must be at least 40% of those hours or that salary being worked or earned immediately prior to the member’s flexible retirement • The reduction in hours or reduction in responsibility allowing the member to be paid a reduced salary must not impact upon the organisation’s ability to carry out its business efficiently and effectively • The individual flexible retirement concerned must support the organisation’s overall business plan and strategy <p>The organisation reserves the right, having considered each individual case, to refuse an application where any of the above criteria are not met</p>
<p>The waiving of the actuarial reduction in those cases where a member voluntarily retires early</p> <p><i>Regulation 30(8)</i></p> <p>(Includes decisions taken by the authority in respect of SYPA employees and on behalf of employers that no longer exist)</p>	<p>Because of the additional costs involved to the authority of waiving the actuarial reduction to member benefits in cases of voluntary retirement it is not envisaged that the authority would normally exercise its discretion in favour of waiving those reductions. However, each case will be considered on its merits and with reference to the circumstances involved of the individual concerned.</p> <p>A potential exception to this policy would be where the individual can make a case for the waiving of such a reduction to be granted on compassionate grounds. An example of “compassionate grounds” may be where the member has been forced to cease work to take up a caring role for an immediate family member, although it is recognised that other grounds could and may exist.</p>

	Every application will be considered on the circumstances of the individual concerned. Financial hardship alone would not constitute 'Compassionate Grounds'
<p>Switching on the 85 year rule for members voluntarily drawing benefits on or after age 55 and before age 60</p> <p><i>Schedule 2 of the Transitional Regulations</i></p>	Because of the potential retrospective impact on the 2013 Fund Valuation and the future additional costs that the exercise of this discretion would bring to the authority, and the fact that the authority does not deem the exercise of this discretion to be necessary in the pursuit of its overall business plan and strategy then it is not anticipated that there will be any instances where the organisation will switch on the rule of 85 for members wishing to retire voluntarily between the ages of 55 and 60. However, every application will be considered on its individual merits and the circumstances involved
<p>The awarding of additional pension to a member</p> <p><i>Regulation 31</i></p>	Because of the costs involved and the likelihood of this provision either being of little or no benefit to the authority, or not being vital to the support and application of the authority's business plan and strategy, then the organisation would not normally expect to exercise its discretion to award additional pension to members. However, each and every application will be considered in the light of the circumstances of the individual case concerned and a decision reached on the merits of that case

6. Implications, including Risks

- Financial – It is impossible to predict the number of requests that will be received that require an exercise of the discretion but each request will be accompanied by a clear indication of the costs appropriate to that particular case.
- Legal – none.
- Diversity – none.
- Risk - none

Gary Chapman
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Background papers used in the preparation of this report are available for inspection in the Pensions Administration Unit.

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SOUTH YORKSHIRE PENSIONS AUTHORITY

Report of the Fund Director

19 JUNE 2014

LGPS CONSULTATION: OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES

1) Purpose of the report

To advise Members that the Government has launched a consultation in response to the call for evidence into the future structure of the Local Government Pension Scheme.

2) Recommendation

That Members note the report and arrange to meet in order to consider the Authority's response to the consultation.

3) Background information

3.1 Members are aware the Government is keen to reform the structure of the LGPS. The latest consultation, launched in May, focuses upon potential savings arising out the establishment of so-called common investment vehicles (CIVs) and their use by LGPS administering authorities, for both listed and alternative asset classes and for the greater use of passive management for all listed assets, including equities and bonds. The documents purport to show that savings of up to £660m can be achieved in this way. Asset allocation decisions will remain with local fund authorities but they will be presented with a list of pre-selected funds to choose from. The exercise is clearly focussed upon cost savings.

3.2 To support the consultation CLG commissioned research from Hymans Robertson to try to establish comprehensive and standardised data on the true cost of investment across the LGPS and the performance achieved.

3.3 At the same time the Government has argued that if such savings are achieved the level of fund deficits will be significantly reduced.

3.4 It is clear that full fund mergers have been ruled out at least for now.

3.5 If the recommendations put forward are adopted on a mandatory basis across all LGPS funds there would be major implications for governance at administering authority level as well as portfolio level.

3.6 In presenting the proposals local government minister Brandon Lewis has not been afraid to court controversy. At the National Association of Pension Funds Local Authority Conference he is reported as saying that "there wouldn't be deficits" in the Scheme if those funds following active management were outperforming and queried whether funds were "telling me

the truth". Professional Pensions magazine reported that these "ill-judged comments" were not well received. Improving investment returns is only one means of reducing deficits and is not the major one. NAPF Chief Executive Joanne Segars has stressed the importance of value over low cost and argued that funds should be provided "with sufficient flexibilities to invest in accordance with their local circumstances where that is shown to add value".

- 3.7 In the light of these and other comments, the majority of which are critical of the arguments put forward and the data analysis, there does appear to be some re-assessment taking place within Government.
- 3.8 Attached to this report are the CLG consultation document (25 pages) and the Hymans Robertson report (106 pages). Also attached is a paper prepared by Mercers (50 pages) presenting some thoughts upon the proposals.
- 3.9 If accepted, these proposals will have significant implications for the Authority, the Fund and employees. It is suggested, therefore, that a fully considered response be sent to the Government and Members are asked to arrange a special meeting to consider the content of such a response.
- 3.10 The consultation closes at 11.45 am on 11 July 2014.

4) Implications

4.1 Financial

There will be potentially significant implications for the Authority if these proposals are implemented depending upon the exact nature of the outcome.

4.2 Legal

There will be potentially significant implications for the Authority if these proposals are implemented depending upon the exact nature of the outcome.

4.3 Diversity

There are no diversity implications.

4.4 Risk

There are risks associated with this report but the details will necessarily have to await the outcome of the consultation.

John Hattersley
Fund Director

Telephone contact 01226 772873

Background papers used in the preparation of this report are available for inspection at the offices of the South Yorkshire Pensions Authority

Other sources and references: CLG; Hymans Robertson; Mercers; Professional Pensions



Department for
Communities and
Local Government

Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies

Consultation

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1. The consultation process and how to respond

Scope of the consultation

Topic of this consultation:	The structure of the Local Government Pension Scheme and opportunities to reduce administration and investment management costs.
Scope of this consultation:	The consultation sets out the evidence for proposals for reforms to the Local Government Pension Scheme and opportunities to deliver savings of £660 million a year for local taxpayers. The Government seeks respondents' views on the proposals set out in section four, and asks respondents to consider how if adopted, these reforms might be implemented most effectively.
Geographical scope:	This consultation applies to England and Wales.
Impact Assessment:	It is not possible to provide an impact assessment at this stage as the detailed mechanism needed to implement the proposed reforms is still being developed.

Basic Information

To:	The consultation is aimed at all parties with an interest in the Local Government Pension Scheme and in particular those listed on the Government's website: https://www.gov.uk/government/publications/local-government-pension-scheme-regulations-information-on-who-should-be-consulted
Body/bodies responsible for the consultation:	Secretary of State, Department for Communities and Local Government. The consultation will be administered by the Workforce, Pay and Pensions division.
Duration:	The consultation will last for 10 weeks, opening on 1 May and closing on 11 July 2014.
Enquiries:	Enquires should be sent to Victoria Edwards. Please email LGPSReform@communities.gsi.gov.uk or call 0303 444 4057.
How to respond:	Responses to this consultation should be submitted to LGPSReform@communities.gsi.gov.uk by 11 July 2014 . Electronic responses are preferred. However, you can also write to: Victoria Edwards

	<p>Department for Communities and Local Government Zone 5/F5, Eland House Bressenden Place London, SW1E 5DU</p> <p>Please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please give a summary of the people and organisations it represents and where relevant, who else you have consulted in reaching your conclusions.</p>
After the consultation:	The responses to the consultation will be analysed and a Government response published. Should any legislative changes be needed, a further consultation will follow.
Agreement with the Consultation Principles:	This consultation has been drafted in accordance with the Consultation Principles.

Background

Getting to this stage:	<p>This consultation has been developed drawing on three sources of evidence:</p> <ul style="list-style-type: none"> • A call for evidence on the future structure of the Local Government Pension Scheme, which ran from 21 June to 27 September 2013. 133 responses were received and analysed, helping to inform this consultation. • An analysis of the responses to the call for evidence provided by the Shadow Scheme Advisory Board. • Supplementary cost-benefits analysis of proposals for reform commissioned from Hymans Robertson using the Contestable Policy Fund. The commission did not extend to making recommendations. <p>The Shadow Board's analysis, the Hymans Robertson report and the Government's response to the call for evidence are all available on the Government's website: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.</p>
Previous engagement:	<p>As outlined above, this consultation follows a call for evidence that gave anyone with an interest in the Scheme the opportunity to inform the Government's thinking on potential structural reform. The call for evidence was run in conjunction with the Local Government Association and the responses were shared with the Shadow Scheme Advisory Board, which provided the Minister for Local Government with their recommendations and analysis of the responses.</p> <p>The call for evidence also drew on a round table event that took place on 16 May 2013 with representatives of administering</p>

	authorities, employers, trade unions, the actuarial profession and academia. This event discussed the potential for increased co-operation within the Scheme, including the possibility of structural change to the existing 89 funds.
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Additional copies

- 1.1 This consultation paper is available on the Government's website at: <https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>

Confidentiality and data protection

- 1.2 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).
- 1.3 If you want the information that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act 2000, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, in itself, be regarded as binding on the Department.
- 1.4 The Department will process your personal data in accordance with the Data Protection Act 1998 and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties. Individual responses will not be acknowledged unless specifically requested.

Help with queries

- 1.5 Questions about the policy issues raised in the document can be sent to LGPSReform@communities.gsi.gov.uk.
- 1.6 A copy of the Consultation Principles is at www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance. Are you satisfied that this consultation has followed these principles? If not or you have any other observations about how we can improve the process please email: consultationcoordinator@communities.gsi.gov.uk
- 1.7 Alternatively, you can write to:

DCLG Consultation Co-ordinator,
Zone 8/J6, Eland House,
Bressenden Place
London SW1E 5DU.

2. Introduction and background

Introduction

- 2.1 The Government believes that there is scope for significant savings, of £660 million per year, to be achieved through reform of the Local Government Pension Scheme. To that end, from 21 June to 27 September 2013, the Government ran a call for evidence on structural reform of the Local Government Pension Scheme. The paper asked respondents to consider what might be done to improve fund performance and drive efficiencies across the Scheme.
- 2.2 This consultation represents the next step in reform of the Scheme, building on the responses to the call for evidence and further cost benefit analysis of potential options for reform. It sets out the Government's preferred approach to reform and seeks views on the proposals.

Background

- 2.3 With assets of £178 billion in 2012-13, the Local Government Pension Scheme is one of the largest funded pension schemes in Europe. Several thousand employers participate in the Scheme, which has a total of 4.68 million active, deferred and pensioner members.¹ The Department for Communities and Local Government is responsible for the regulatory framework governing the Scheme in England and Wales.
- 2.4 The Scheme is managed through 89 funds which broadly correspond to the county councils following the 1974 local government reorganisation as well as each of the 33 London Boroughs. In most cases, the fund administering authorities are upper tier local authorities such as a county or unitary council, but there are also some administering authorities established specifically to manage their fund, for example the Environment Agency Pension Fund and the London Pension Fund Authority. The fund authorities have individual governance and working arrangements. Each fund has its own funding level, cash-flow and balance of active, deferred and pensioner members, which it takes into account when adopting its investment strategy, which is normally agreed by the councillors on the fund authority's pensions committee.
- 2.5 Employer contributions to the Scheme, the majority of which are funded by taxpayers, were more than £6 billion in 2012-13. The costs of managing and administering the scheme were estimated as being £536 million in 2012-13.² However, the actual costs are likely to be rather higher; the investment costs alone have recently been estimated as in excess of £790 million.³ While investment returns and the costs of providing

¹ Scheme asset value and membership figures taken from Department for Communities and Local Government statistical data set - Local government pension scheme funds summary data: 2012 to 2013 <https://www.gov.uk/government/statistical-data-sets/local-government-pension-scheme-funds-summary-data-2012-to-2013>

² Local government pension scheme funds summary data: 2012 to 2013

³ Department for Communities and Local Government: Local Government Pension Scheme structure analysis, Hymans Robertson p.11. <https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>

benefits are the most significant drivers of the overall financial position of funds, management costs also have an impact on funding levels and thus the pension contributions made by employers and scheme members.

2.6 Under the Public Service Pensions Act 2013, there will be a requirement for a national scheme advisory board, as well as a local board for each of the 89 funds. The regulations that will establish national and local governance arrangements have not yet been made and the Department will be consulting on these issues shortly. In the meantime, scheme employers and the trade unions have established a Shadow Board, which has been considering a number of issues connected with the Scheme, including its efficient management and administration. In addition, the Minister for Local Government has asked the Shadow Board to consider how the transparency of the funds might be improved.

Getting to this stage

2.7 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 might be made more sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers.

2.8 Lord Hutton's final report was published on 10 March 2011 and formed the basis for major reforms to all public service pension schemes. The new Local Government Pension Scheme which came into effect on 1 April 2014 is the first scheme to be introduced that follows Lord Hutton's principles for reform as enacted in the Public Service Pensions Act 2013.

2.9 Lord Hutton highlighted the collaborative approach being taken by funds within the Local Government Pension Scheme and recommended that the benefits of co-operative working between local government pension funds and opportunities to achieve efficiencies in administration more generally should be investigated further.⁴

Recommendation 23: Central and local government should closely monitor the benefits associated with the current co-operative projects within the Local Government Pension Scheme, 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.

2.10 More generally, Lord Hutton went on to comment about the need for change and improved scheme data. At paragraph 6.1 he said:⁵

⁴ Independent Public Service Pensions Commission: Final Report p.17
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207720/hutton_final_100311.pdf

⁵ Independent Public Service Pensions Commission: Final Report p.122

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.

- 2.11 The Department therefore co-hosted a round-table event to consider these issues with the Local Government Association in May 2013. There were 25 attendees from administering authorities, employers, trade unions, the actuarial profession and academia. The discussion centred on the possible aims of reform, the potential benefits of structural change and the work required to provide robust evidence to analyse the emerging options and establish a starting point and target.
- 2.12 The objectives for reform identified at the round-table fed into a call for evidence on the future structure of the Scheme, which ran from 21 June to 27 September 2013. This asked respondents to set out the data required to enable a reliable comparison of fund performance and to consider how the administration, management and structure of the Scheme might be reformed to address the objectives identified at the round-table event. These objectives included reduced fund deficits and improved investment returns, as well as reduced investment fees and administration costs, greater flexibility of investment, especially in infrastructure and more use of better in-house investment management.
- 2.13 133 responses were received to the call for evidence and these submissions have been analysed to inform this consultation. A separate response to the call for evidence has been published and is available at: <https://www.gov.uk/government/consultations/call-for-evidence-on-the-future-structure-of-the-local-government-pension-scheme>. The Shadow Scheme Advisory Board has also reviewed the responses to the call for evidence and submitted recommendations to the Minister for Local Government. Its findings have been considered in the development of this consultation and are available via a link on its webpage or from the Shadow Board's website: <http://www.lgpsboard.org/index.php/structure-reform/board-analysis-menu>.
- 2.14 To support the call for evidence, the Minister for Local Government and the Minister for the Cabinet Office commissioned additional analysis using the Contestable Policy Fund. The Fund gives Ministers direct access to external policy advice through a centrally managed match fund, allowing Ministers to draw directly on the thinking, evidence and insight of external experts. Following a competitive tender process, Hymans Robertson were selected to establish the aggregate performance of the Scheme by asset class and to provide a detailed cost-benefit analysis of three potential options for reform:
- Establishing one common investment vehicle for all funds;
 - Creating five to ten common investment vehicles for fund assets
 - Merging the existing structure into five to ten funds.
- 2.15 The analysis set out the costs and benefits of each option; the time required to realise savings; the practical and legal barriers to implementation and how they might

be addressed. Hymans Robertson's findings have been reflected in this consultation, alongside the call for evidence responses and analysis by the Shadow Scheme Advisory Board. A copy of the Hymans Robertson report, which did not extend to making recommendations, is available on the Government's website:

<https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>

3. The case for change

Summary of the proposals

3.1 Having considered the responses to the call for evidence, as well as the Shadow Board’s recommendations and the Hymans Robertson report, the Government believes that the following steps are needed to help ensure that the Scheme remains affordable in the long term for both employers and members. The proposals aim to balance the opportunities from aggregation and scale whilst maintaining local accountability.

3.2 The package of proposals set out in this document include:

- Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs.
- Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market.
- Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme.
- A proposal not to pursue fund mergers at this time.

3.3 Hymans Robertson’s analysis, which was based on detailed, standardised data, demonstrated that the significant savings could be achieved by the Scheme if all of the funds adopt the following proposals in full. The Government is interested in exploring these proposals further with a view to maximising value for money for taxpayers, Scheme employers and fund authorities.

Proposal	Estimated Annual saving
Moving to passive fund management of all listed assets, accessed through a common investment vehicle.	£420 million
Ending the use of “fund of funds” arrangements in favour of a common investment vehicle for alternative assets	£240 million

3.4 The saving of £420 million associated with moving to passive management of listed assets is comprised of two elements:

- Reduction in investment fees: £230 million
- Reduction in transaction costs: £190 million

The performance that is reported by the Local Government Pension Scheme funds is net of these transaction costs.

3.5 The savings associated with passive fund management can be achieved quickly, within one to two years. The annual savings arising from using common investment vehicles for alternative assets would build gradually, with the full annual savings reached over 10 years, as existing contracts came to an end.

- 3.6 This package of proposals provides a clear opportunity to substantially reduce the investment costs of the Scheme. They are most effective when adopted by all 89 funds and the Government proposes to implement them together. Indeed, the passive management of listed assets could be most easily facilitated through a common investment vehicle.
- 3.7 In addition, the cost of investment has been estimated to be considerably higher than previously reported. Recognising the need for more reliable and comparable performance and cost data, the Government will continue to work with the Shadow Scheme Advisory Board to improve the transparency of fund data as set out in paragraph 5.3.
- 3.8 The remainder of this section sets out the objectives and rationale for reform and the evidence underpinning the approach taken. A more detailed explanation of the proposals for reform is provided in section four.

The objective of reform

- 3.9 The cost of the Local Government Pension Scheme has risen considerably since the 1990s, with the increased costs falling predominantly on Scheme employers and local taxpayers. In England alone, the cost to Scheme employers has almost quadrupled from £1.5 billion in 1997-98 to £5.7 billion in 2012-13. Indeed, when the Welsh funds are also considered, the total cost to employers is around £6.2 billion a year.⁶ The Government has already taken action to reduce the cost of the Scheme and make it more sustainable and affordable to employers and taxpayers in the long term. For example, the new 2014 Scheme with a revised benefit structure came into effect on 1 April, helping to reduce and rebalance the cost between members and employers. However, it is clear from examining the aggregate data on the Scheme which has come to light as part of this review, that there is more that can be done to improve the sustainability of the funds.
- 3.10 At present, the funds report that administration and investment management costs are £536 million per year, of which £409 million is attributed to investment. Indeed, the reported cost of investment in cash terms has continued to rise in recent years: from £340 million in 2010-11; to £381 million in 2011-12; and £409 million in 2012-13.⁷ In fact, using more detailed and standardised data CEM Benchmarking Incorporated, as sub-contractors to Hymans Robertson, identified that the fees for investment management of the Scheme could be much higher than reported, at in excess of £790 million. Some of the fees for investment management are not fully transparent to the funds and are therefore difficult to quantify. In practice, the actual cost of investment to the funds is likely to be even higher than £790 million, as their analysis did not include other costs in their calculation such as transaction costs and performance related fees on alternative assets.
- 3.11 Coupled with the responses to the call for evidence, Hymans Robertson's analysis has provided a system review, shedding light on the aggregate performance of the Scheme by asset class, as well as the transactions and processes that underpin the

⁶ Local government pension scheme funds summary data: 2012 to 2013

⁷ Local government pension scheme funds summary data: 2012 to 2013

costs of investment. The work carried out by CEM Benchmarking Incorporated found that while funds were paying investment fees comparable with a peer group of funds of much larger size with similar mandates, there remained considerable scope for savings through a more efficient approach to investment.

- 3.12 The priorities of reducing fund deficits and improving investment returns set out in the call for evidence are underpinned by one overarching objective: that the Scheme remains sustainable and affordable for employers, taxpayers and members in the long term. Having considered this new aggregate view of the funds, the evidence indicates that there are opportunities to reduce costs without damaging overall Scheme performance. The Government therefore believes that it is right to consider opportunities to reduce costs and deliver value for money for employers and taxpayers, in pursuit of the overarching objective of a more sustainable and affordable Scheme.

Reducing fund costs or tackling deficits?

- 3.13 Although the call for evidence was developed around the primary objectives of reducing fund deficits and improving investment returns, very few responses set out ideas for managing deficits in a different way. The Shadow Scheme Advisory Board argued that more thinking could be done to consider how deficits might be addressed in the longer term. Its sixth recommendation stated⁸:

The Board will support the Government by (a) developing a shortlist of feasible options for managing deficits and (b) conducting further research on the costs and benefits of the key options for reform.

- 3.14 The Government agrees that opportunities to improve funding levels should continue to be explored and looks forward to considering the Shadow Board's proposals for alternative ways of managing deficits. **Respondents to this consultation are also invited to submit any feasible proposals for the reduction of fund deficits.**
- 3.15 While very few submissions effectively tackled deficit reduction, both public and private sector respondents recognised that the Scheme may benefit from addressing the secondary aim of reducing investment costs, partly by managing investments more efficiently. Taking action to reduce the cost of running the Scheme will help to meet this objective by increasing the funding available for investment. In the longer term, this should help to improve the funding level of the Scheme and reduce the pressure on employer contribution rates. This consultation therefore focuses on the cost savings to be found through collaboration and more efficient investment.

Achieving scale to reduce fund costs

- 3.16 There is already a growing consensus across the Local Government Pension Scheme that there are opportunities to deliver further efficiencies and savings for local taxpayers through collaboration. When the call for evidence was launched, funds in

⁸ Call for Evidence on the Future Structure of the Local Government Pension Scheme: The Local Government Pension Scheme Shadow Scheme Advisory Board analysis and recommendations, p.4 <http://www.lgpsboard.org/images/CFE/20140115SSABreportFINAL>

Wales, Scotland and London had already begun to research the benefits of scale and explore the relative merits of mergers and common investment vehicles. Similarly, shared administration arrangements had been established in a number of areas including across Kensington and Chelsea, Hammersmith and Fulham, and Westminster; as well as in Northamptonshire and Cambridgeshire.

3.17 Several responses to the call for evidence cited earlier reports or academic research into the benefits of fund size, drawing heavily on the exploratory work of Scotland, Wales and London, as well as the international experience of countries including Australia and Canada.⁹ On balance, these reports found that there was no clear link between investment returns and fund size. However, they did show that there were significant benefits to scale, such as lower investment and administration costs, easier access to alternative asset classes like private equity and hedge funds, and improved governance. This view was also reached by the Shadow Board in its analysis of the call for evidence responses, which argued that:¹⁰

The evidence appears to show indirect benefits of larger fund sizes, although any direct link between fund size and investment return in the Local Government Pension Scheme is inconclusive.

3.18 Although managed as 89 funds, with an asset value of £178 billion the Local Government Pension Scheme clearly has the potential to achieve the benefits of scale realised by larger funds. Whilst many of the funds have gone some way to achieving this by using procurement frameworks or establishing joint-working arrangements, there is more that can be done. This consultation will set out how using common investment vehicles and passive management for listed assets can in the long term lead to savings of over £660 million a year for the Scheme.

Achieving efficiencies and safeguarding local accountability

3.19 The call for evidence asked interested parties to suggest options for reform that would best meet the primary and secondary objectives set out in paragraph 2.12 above. A range of tools and approaches to achieving greater economies of scale were suggested, with fund mergers, common investment vehicles, and existing collaborations such as procurement frameworks all discussed extensively.

3.20 Two themes were discussed consistently when respondents sought to evaluate the merits of the main proposals for reform:

- The potential cost and time required for implementation;
- The importance of local accountability.

Costs and benefits of the proposals

3.21 Around half of the responses discussed the cost effectiveness of merging funds and how this might be implemented. Many argued that while savings could be achieved as a result of economies of scale, more analysis was needed to ensure that the benefits

⁹ A list of the most commonly referenced papers can be found on the Shadow Scheme Advisory Board's web-pages: <http://www.lgpsboard.org/index.php/structure-reform/responses-public-view>

¹⁰ The Local Government Pension Scheme Shadow Scheme Advisory Board analysis and recommendations, p.3

of mergers outweighed the cost and time required to implement them successfully.

3.22 Analysis was undertaken by Hymans Robertson who evaluated the costs and benefits of three options for reform over 10 years. They found that although significant savings could be realised over the period by amalgamating into five funds, merger could take around 18 months longer to implement than common investment vehicles; the delay in the emergence of savings leading to a significant reduction in the net present value of savings over 10 years. The report also showed that the savings achieved by pooling assets into two common investment vehicles would be slightly higher than if 10 were used.¹¹

Possible model for reform	Net present value of savings over 10 years (£ billions)
Assets pooled into two common investment vehicles	£2.8
Assets pooled in 10 common investment vehicles	£2.6
Fund assets and liabilities merged into five funds	£1.9

3.23 The calculations shown exclude the impact of the reduced transaction costs, which Hymans Robertson showed would also help to deliver additional savings of £1.9 billion for the Scheme over 10 years.

3.24 A number of fund authorities also submitted evidence of the benefits to their fund of procurement frameworks such as the National LGPS Frameworks. A procurement framework provides authorities with a short list of organisations who can bid for contracts, reducing the time and cost of running a more substantial process.

National LGPS Frameworks' response to the call for evidence cited one fund who had used their actuarial framework to secure services at a procurement cost of £4,000 instead of the estimated £30,000-£40,000 required for a full procurement process. If this same rate of savings applies to Global Custodian procurements, with costs again reduced by 90 per cent, the Framework believes savings of £90,000 per fund can be found.

3.25 Although there are clear benefits to using frameworks, the scale of savings achievable does not match those possible through more substantial reform such as common investment vehicles. However, the Government believes that there is still a role for procurement frameworks to play in delivering savings for the Scheme and is keen to see this opportunity taken up by more of the funds.

Local accountability

3.26 Most call for evidence responses stressed the importance of local accountability and the direct link to elected councillors, which would be lost if funds were merged. At present the authority's Councillors, usually through the pensions committee, are asked to agree the fund's investment strategy. The authority then publishes an annual report which details the costs and investment performance of the fund, enabling the public to assess how effective the investment strategy has been. Some respondents argued that this allows local taxpayers to hold the fund and local councillors to account. As one fund authority stated:

¹¹ Local Government Pension Scheme structure analysis; Hymans Robertson p.6.

“There is a clear, democratic link to local voters and businesses through elected members sitting on pensions committees...

The regulatory requirements to produce an annual report and accounts and policy statements...ensure that key information on the management of funds is held in the public domain. This approach ensures local and national accountability.

The Pensions Committee believes that a forced merger of funds could only weaken accountability and the democratic link.”

3.27 However, a smaller number of respondents queried the benefit of this link, emphasising the importance of Myners Principle 1 – that administering authorities should ensure that investment decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make effective decisions and monitor their implementation.¹² Although Councillors on the committee receive training, there is a risk that they have neither a background in finance nor the time to invest in developing the knowledge required to a sufficient depth. In addition, some suggested that the frequent turnover of Pensions Committee members as a result of the electoral cycle made it difficult to ensure a long term view of the investment strategy.

3.28 The ability to set a tailored investment strategy and determine the asset allocation locally was seen as vital amongst respondents from both the public and private sectors. This is perceived as an important tool for managing each fund’s unique funding position and cash-flow requirements. Several respondents also emphasised the importance of local accountability as a means to ensuring the representation of Scheme members and employers. As one Scheme employer set out in their response to the call for evidence:

The existing arrangements in English County Council and London Funds promote and facilitate a clear link between the relevant individual Fund and employing bodies... As the public sector continues to fragment the number of scheduled/ admitted bodies will increase making all the more important a genuinely “local”, as presently exists, link between employers and Funds.

3.29 Under a fund merger, asset allocation would need to take place at the new, larger fund authority level. However, common investment vehicles offer greater flexibility and can be established with the asset allocation made either centrally within the vehicle, or by the local fund authority.

3.30 Around 15 responses to the call for evidence stressed that common investment vehicles could achieve the benefits of scale attributed to fund mergers, without the associated disruption, implementation time, cost or loss of local accountability. As one fund outlined when talking of pooling assets in common investment funds:

¹² Pensions Regulator – adaptation of Myners principles for the Local Government Pension Scheme
<http://www.thepensionsregulator.gov.uk/docs/igg-myners-principles-update.pdf>

This approach might realise significant scale benefits more speedily and with less disruption, while still retaining local accountability and decision making on key matters such as deficit recovery plans and asset allocation.

3.31 Having considered the responses to the call for evidence and Hymans Robertson's analysis, the Government has decided not to consult on fund mergers at this time. However, there remains a strong case for achieving economies of scale through the use of common investment vehicles.

4. Proposals for reform

Proposal 1: Common investment vehicles

The case for change

- 4.1 Using common or collective investment vehicles to aggregate the Scheme's investments and moving to passive investment of listed assets has the potential to deliver significant savings of over £660 million per year, through reduced investment and other costs for all asset classes in the Scheme. These savings were set out by Hymans Robertson, whose report showed that it was likely that the economies of scale from aggregation would be best accessed through common investment vehicles.
- 4.2 Further savings arise from the efficient structure offered by a common investment vehicle. Within any common investment vehicle or pooled fund, money will flow in and out as investors purchase and redeem units in the fund. If those buying and selling units within a pool can be matched, fund managers will not need to sell assets to meet redemption requests and as such the volume of transactions can be minimised, improving cost efficiency.
- 4.3 Common investment vehicles may also deliver savings by reducing the use of "fund of funds" to access alternative assets, such as hedge funds, private equity, property and infrastructure. Fund of funds are used to achieve the scale required for individual funds to make investments they may not be able to access directly. However, this introduces an additional layer of fees, increasing the total cost of investment. Setting up a common investment vehicle would help funds achieve the scale required to invest, without the high costs associated with a "fund of funds".
- 4.4 Hymans Robertson found that investment fees for alternative assets were particularly high compared to other asset classes, accounting for less than 10 per cent of the Scheme's assets, but for at least 40 per cent of fees.¹³ The firm's analysis showed that savings of up to £240 million per year could be achieved by ending the use of "fund of funds" across the Scheme, provided that the existing contracts were permitted to run their full course in order to avoid potentially significant termination costs. Consequently, although some savings would begin to accrue straight away, this annual total would be reached over 10 years.¹⁴
- 4.5 The wider benefits of common investment vehicles include improved transparency. As the funds would be subject to the same investment costs and asset managers, the effect of asset allocation and local decision making would become more transparent, revealed in part by the variation in investment returns. This should provide the Department, fund authorities and taxpayers with an opportunity to compare the effectiveness of a fund's asset allocation. In addition, the vehicle could provide a platform for the operation of national framework agreements, helping to minimise the cost of procurement and other administrative costs of investment such as actuarial and custodial services.

¹³ Local Government Pension Scheme structure analysis; Hymans Robertson p.11

¹⁴ Local Government Pension Scheme structure analysis; Hymans Robertson p.7

- 4.6 A common investment vehicle for alternative assets could also help to improve governance by providing an independent assessment of alternative investment strategies, particularly for local infrastructure investment. A pooled vehicle could make it easier for funds to invest in infrastructure when appropriate opportunities arise, by providing a cost effective way to realise the scale needed.
- 4.7 As discussed in paragraph 3.28, local determination of a fund's asset allocation was seen as a vital consideration amongst respondents to the call for evidence. A common investment vehicle could be designed to allow asset allocation to remain at local fund authority level, consistent with ensuring that decisions are taken in line with existing local accountabilities.

Proposal for reform

- 4.8 The Government believes that there are clear advantages to funds in pooling their assets in common investment vehicles for all asset classes, but that all asset allocation decisions should remain with the fund authorities.
- 4.9 Hymans Robertson's analysis demonstrated that there were slightly higher returns over ten years if the funds were organised through one common investment vehicle for listed assets and a second for alternatives, rather than a greater number. This evidence suggests that savings will be maximised by the creation of two vehicles: a single common investment vehicle for listed assets organised by asset class (for example, UK equity, European equity, UK bonds and so on), and a second vehicle for alternative assets.
- 4.10 Concentrating the Scheme into two common investment vehicles may increase its exposure to risk. Several public and private sector responses to the call for evidence also stressed that capacity constraints may begin to apply if a fund became too large. As one fund authority stated in their response to the call for evidence:

Furthermore there may be issues about capacity – the best fund managers may be closed to new business, and even if indeed the capacity exists, they may be reluctant to have too much business from a single client (as that creates business risks).

- 4.11 However, the Government believes that the exposure to risk should be mitigated if the asset allocation remains as diversified as it is at present. The Hymans Robertson report noted that the issue of capacity constraint would not apply to the common investment vehicle for listed assets if it were invested in passive funds.

- Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.**
- Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?**
- Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?**

Further considerations

A. Changes to the investment regulations

4.12 The current investment regulations place restrictions on the amount of a fund that can be invested in certain types of vehicle, for example limited partnerships in aggregate are subject to a limit of 30 per cent. In addition, while some types of common investment vehicle are listed within the regulations, others are not. Squire Sanders, as subcontractor to Hymans Robertson, indicated that secondary legislation could be used to reform the investment regulations, removing the anomalies created between different types of vehicle and any ambiguity about the funds' ability to invest substantially in common investment vehicles.

4.13 The Government recognises that the investment regulations are in need of review. The Department will consult separately on reforms to these regulations, including any changes required to facilitate investment in common investment vehicles. **However, any initial thoughts would be welcome in response to this consultation.**

B. The type of common investment vehicle

4.14 The term collective or common investment vehicle can be used very broadly and take different forms. At this time, the Government would like to seek views on the specific type of common investment vehicle to be used, but anticipates that the following principles might underpin the design:

- Pooling of assets, possibly on a unitised or share basis;
- Safeguards for individual funds, for example through Financial Conduct Authority authorisation;
- Governance arrangements considered as part of wider governance reforms arising from 2013 Public Service Pensions Act;
- Strategic asset allocation remains with individual funds; and
- An option for other funded public service pension schemes to participate in the common investment vehicles if they wish.

4.15 There are a number of types of common investment vehicle available that might fulfil some or all of these principles. One such model currently under review is the tax transparent Authorised Contractual Scheme.¹⁵ However, careful consideration of the governance arrangements for any common investment vehicle would be needed before any more detailed proposals are developed.

Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

Proposal 2: Passive fund management of listed assets

4.16 There are two main types of investment approach, which can be used individually or in combination.

- Passive management typically invests assets to mirror a market in order to deliver a

¹⁵ More information can be found on the Financial Conduct Authority's website:

<http://www.fca.org.uk/firms/firm-types/collective-investment-schemes/authorised-contractual-schemes>

return comparable with the overall performance of the market being tracked.

- An actively managed fund employs a professional fund manager or investment research team to make discretionary investment decisions on its behalf.

4.17 The Local Government Pension Scheme makes use of both of these approaches, although active management is used more extensively than passive. By applying their expertise, it is hoped that active managers will deliver a level of return in excess of the market's performance, although this comes at a much higher cost than passive management. A few funds gave examples of how they had benefited from active management in their response to the call for evidence.

For example, the active manager of one fund had outperformed their performance benchmark by 3.2 per cent since 2007 and by 5.7 per cent in the last three years.

4.18 However, Hymans Robertson cite evidence from defined benefit pensions funds in the United States which shows that for equities, returns are explained predominantly by market movements and asset allocation policy, with active management playing no role¹⁶.

The case for change

4.19 There are some risks associated with paying for active management, since not all active managers will be able to achieve returns higher than the market rate. Hymans Robertson was therefore asked to examine the performance of the Scheme in aggregate to see whether the funds' overall performance was benefiting from active management.

4.20 Hymans Robertson considered the performance before fees of equities and bonds in aggregate across the Scheme over the 10 years to March 2013. This new analysis, evaluating the funds' investment as one Scheme, showed that there was no clear evidence that the Scheme as a whole had outperformed the market in the long term. They concluded that listed assets such as bonds and equities could have been managed passively without affecting the Scheme's overall performance.

Equity market ¹⁷	UK	North America	Europe excluding UK	Japan	Developed Pacific excluding Japan	Emerging Markets
FTSE Index	10.7	9.5	11.4	7.4	16.4	18.2
Aggregate Local Government Pension Scheme	10.8	8.4	11.6	7.5	17.3	17.1
Excess active return gross of fees	0.1	-1.1	0.2	0.1	0.9	-1.1

¹⁶ Local Government Pension Scheme structure analysis; Hymans Robertson, p.19. Data based on 'Rehabilitating the Role of Active Management for Pension Funds' by Michel Aglietta, Marie Briere, Sandra Rigot and Ombretta Signori.

¹⁷ Local Government Pension Scheme structure analysis, Hymans Robertson, table 9 p.20. Sources: State Street Investment Analytics (The WM Company), CEM Benchmarking Inc. *This is Hymans Robertson's estimate of the extra cost which reflects the low fees that the Local Government Pension Scheme in aggregate pay for active management of UK equities. The global cost premium is estimated by CEM as 0.56%

Extra cost (per annum) of active	0.34*	0.27	0.20	n/a	0.49	0.53
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- 4.21 This analysis of investment return is specific to the performance of the Local Government Pension Scheme in aggregate.
- 4.22 In their report, Hymans Robertson quantified the fees savings achievable from moving to passive management of listed assets as £230 million per annum, assuming that all funds participated.¹⁸
- 4.23 In addition to the savings arising from lower fees, a move to passive management will also reduce the level of asset turnover. This occurs as investment managers buy and sell assets within an asset class. Both passive and active managers buy and sell assets, but turnover is generally much higher, and therefore more costly, under active management. Hymans Robertson estimated that if all of the Scheme's UK and overseas equities had been managed passively in the financial year 2012-13, turnover costs would have been around £190 million lower.¹⁹
- 4.24 Hymans Robertson also conducted a detailed analysis of the transition methodology and costs to move to passive management of all listed assets. They identified that the cost of transition could be around £215 million.²⁰ These transition costs are approximately equal to the savings achieved from reduced turnover costs in just one year.
- 4.25 Their analysis of transition also concluded that any market disruption will be limited as there is no proposed change to asset allocation. Hymans Robertson suggested that a single coordinated but phased transition would minimise market impact.

Proposals for reform

- 4.26 The Hymans Robertson report concluded that if the Scheme acts collectively and moves all listed assets into passive management, investment fees and turnover costs could be reduced by up to £420 million per year. This represents a significant saving for the funds, employers and local taxpayers which would begin to accrue within two years of moving to passive management of listed assets.
- 4.27 Having considered this analysis, the Government believes that funds should make greater use of passive management for all listed assets such as bonds and equities. Alternative assets such as property, infrastructure or private equity would continue to be managed actively through a separate common investment vehicle.

Further consideration

A. Take up of passive management

- 4.28 A number of the responses to the call for evidence emphasised that a small movement in investment performance has the potential to have a more significant impact on the Scheme's finances than the savings achievable from investment management fees. It is therefore important that full consideration is given to the

¹⁸ Local Government Pension Scheme structure analysis; Hymans Robertson p.7

¹⁹ Local Government Pension Scheme structure analysis; Hymans Robertson p.7

²⁰ Local Government Pension Scheme structure analysis; Hymans Robertson p.17

impact of a move to passive management on overall Scheme performance.

4.29 The Government acknowledges that, as set out in paragraph 4.17, there are funds who feel they have benefited from active management. However, Hymans Robertson's analysis of the savings associated with moving to passive management of listed assets is underpinned by a full consideration of investment performance by asset class across the Local Government Pension Scheme. This analysis shows that a move to passive management would not have damaged returns across the Scheme as, in aggregate, the funds' investment performance has replicated the market in much the same way as passive investment.

4.30 The Government therefore wishes to explore how to secure value for money for taxpayers, Scheme members and employers through effective use of passive management, while not adversely affecting investment returns. There is a range of options open to Government and the funds to achieve this:

- Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.
- Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.
- Fund authorities could be required to manage listed assets passively on a "comply or explain" basis.
- Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report

Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

5. Additional considerations

Data transparency

- 5.1 Although all of the funds publish annual reports setting out their costs and investment returns, a theme common to the majority of responses to the call for evidence was the need for greater transparency and more comparable data. As one fund outlined in its response to the call for evidence:

There is currently insufficient information available to permit a robust comparison of different Local Government Pension Scheme funds. This includes data on investment performance, investment management costs, pension administration costs, and actuarial information. All of this data should already be available within each Local Government Pension Scheme fund but there needs to be a central repository to collate and analyse the information and ensure that it is comparable.

- 5.2 Moving to a common investment vehicle will help to facilitate this transparency, as the investment fees derived from a common vehicle will be more comparable. It will also help to highlight the effect of asset allocation and fund decision making. Since the funds would be investing through the same vehicles, the effect of asset allocation will be more easily seen from the resulting variation in investment returns. The common investment vehicles would also allow greater clarity over variations between asset allocations and actuarial discount rates.
- 5.3 However, it is clear that further improvements are needed to ensure published Scheme data is comparable between funds. The Minister for Local Government has asked the Shadow Board to look at data transparency in more detail and it has already made progress in this area, bringing together all of the funds' annual reports on its website. The Government is keen to support the Shadow Board in this work and looks forward to working with it to ensure more comparable data is available in the future.

Procurement frameworks

- 5.4 As set out in paragraph 3.24, there are clear advantages and savings to making use of the National LGPS Frameworks. The frameworks provide funds with the opportunity to reduce the cost and time associated with procurement. By developing a short list of approved candidates, the frameworks can help funds reduce the time taken to procure a service from six to nine months to a matter of weeks, as well as offering standardised terms and conditions. In addition to offering savings to the funds, the small fee paid by funds to access the framework helps to ensure that the model is self-financing in the long term.
- 5.5 At present, frameworks have been established by the National LGPS Framework for investment consultancy, global custody and benefit and actuarial services. The Government believes that funds can deliver further savings, using these frameworks to procure a range of services including actuarial and investment advice. Funds should give serious consideration to making greater use of these frameworks. In addition, common investment vehicles could be used as a platform from which to operate such frameworks.

Administration

5.6 The question of how to improve the cost effectiveness of administration was posed in the call for evidence as a secondary objective for structural reform. Around 12 submissions suggested that larger funds were able to achieve lower administration costs. Some fund authorities and pensions administrators set out the benefits they had seen from aggregating administration services, arguing that significant savings could be achieved from reduced staff and accommodation costs, greater automation, member and employer self service and I.T cost reductions. For example, as a shared service for fund authorities set out in their response:

Local Government Shared Services (“LGSS”) Pensions Service is a collaborative venture between two Scheme funds established in October 2010, which has already saved £500k per annum in pensions administration.

5.7 However, while these savings are valuable to the Scheme, they are small in comparison to the cost reductions associated with greater passive management of listed assets and the use of common investment vehicles. In addition, as some respondents stressed, the administration of the Scheme is already facing a period of significant change with the introduction of the 2014 Scheme from 1 April 2014.

5.8 Having considered these factors, the Government has decided not to consult on administration reform at this time. However, the call for evidence has highlighted the scope for potential administrative efficiencies as well as the associated risks. At this stage, the Government proposes to allow the administration arrangements for the 2014 Scheme to mature before considering reform any further.

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Department for Communities and Local Government

LGPS structure analysis
December 2013

Linda Selman

John Wright

For and on behalf of Hymans Robertson LLP

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Introduction

There is much that the LGPS currently does well and a substantial body of evidence that administering authorities have been good stewards of invested funds:

- The LGPS has procured investment management services at fee levels that compare favourably with those paid by larger international peers, particularly for investments in traditional asset classes – this is testimony to the cost saving ethos and effectiveness of local authority procurement practice; and
- A number of initiatives have already been established and further pilot projects are underway which aim to reduce costs; these include joint procurement frameworks, collective investment vehicles, shared services and voluntary Fund merger.

Nonetheless, in order to achieve further meaningful savings, everyone in the LGPS community will need to remain committed to pursuing further and more widespread improvements in investment efficiency through collaboration and reform.

The primary purpose of this research project is to quantify the potential for additional **cost savings** across the LGPS using the best objective evidence and data currently available and to assess how those cost savings might be **accessed most readily**.

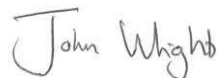
The project deliverables include quantification of potential savings in investment management costs for a range of reform options. However, we were not asked to provide any recommendation on a preferred approach. The preferred approach will be a matter for government to determine after a full consultation.

We are indebted to the commercial organisations and local authorities who made significant contributions to this project by providing performance data, costings and other valuable information that has enabled us to complete this research. We have acknowledged their contributions at the end of this report. The willingness of those organisations to help and the general support we have received from the wider LGPS community during this important project are evidence of the commitment of all involved to make sure that future decisions are based on robust and objective analysis.

This paper is the work of three partner organisations, Hymans Robertson, CEM Benchmarking Inc. (a global firm specialising in the benchmarking of investment performance and costs) and Squire Sanders (UK) LLP (a global law firm with a leading public sector pensions practice). It is the hope of Hymans Robertson and its partners that this report will provide the solid evidence base that is required for a well-informed consultation on the means by which the LGPS can make further cost savings for a sustainable future.



Linda Selman



John Wright

Executive Summary and Key Findings

Purpose of project

- The primary purpose of this research is to quantify the potential for **cost savings** across the LGPS using the best objective evidence and data currently available and to assess how those cost savings might be **accessed most readily**.

Key findings

Investment costs

- Total asset management costs across the LGPS in 2012 were estimated at **£790m (c.44bps of total assets)**, of which £745m was investment management costs and £45m oversight costs
- On a consistent basis total asset management costs for an international peer group of large funds with same asset mix were estimated at **41bps**.
- The investment costs **exclude**:
 - a. performance fees on alternative assets such as private equity, hedge funds, etc. (However, they do include performance fees paid on traditional assets); and
 - b. **turnover costs** (investment performance figures include the impact of turnover costs)
- Overall fees paid to fund managers by the LGPS are slightly lower than those paid by large peers for similar mandates. There is evidence that LGPS funds have been successful in securing particularly low levels of fee on some asset classes.
- The greatest potential for cost savings would result from changes to implementation style (i.e. less use of active managers and less expensive means of investing in alternative asset classes).

Investment performance

- There are some funds which have performed consistently well relative to their peers. However, for the LGPS taken in aggregate, equity performance **before fees** for most geographical regions has been no better than the index.
- This outcome is consistent with wider international evidence which suggests that any additional performance generated by active investment managers (relative to passively invested benchmark indices) is, on average, insufficient to overcome the additional costs of active management.

Traditional asset classes – potential savings

- Greater use of **passive investment** (“trackers”) for listed equities and bonds could save **£230m (13bps)** per year without damaging investment performance in aggregate across the LGPS.
- Greater use of passive investment is also expected to reduce turnover costs. We estimate that the reduction in turnover cost in 2012-13 as a result of investing passively in listed equities would have been c.£190m.
- The turnover costs are a drag on the performance delivered by active management and their impact is included in the reported asset returns.
- The benefits of passive investment for listed securities are likely to be best accessed through one (or a very small number of) pooled arrangement(s). If this asset pool included both LGPS funds and other non-LGPS pooled investments, this would maximise future “crossing” benefits (matching buyers and sellers to reduce transaction costs). The most appropriate type of collective investment vehicle needs to be established as part of next steps.

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- The one-off **transition cost** involved in moving existing LGPS assets into suitable passive investments is estimated to be circa £215m provided the transition is effected over a timescale designed to minimise costs. c.£47m of this is stamp duty.
- To help minimise the transition cost, it would be preferable to have the LGPS implementation carried out as a single co-ordinated exercise; that is what this cost estimate assumes.
- This may seem like a significant up-front cost but it is actually no more than the hidden additional turnover costs incurred in active management which will be saved by investing passively for just one year.
- No additional funding or up-front cash is required from government or from local authorities. Transition costs are met from the assets of the scheme and would be reflected in asset valuations (like other investment transaction and turnover costs).
- Even allowing for other implementation costs, the payback period is likely to be just over **one year** from date of the transition to passive arrangements.

Alternative assets – potential savings

- LGPS funds invest in “**alternative assets**” (private equity, hedge funds, infrastructure) for good reasons (diversification and return). Currently it is difficult for individual funds to access these investments with an appropriate degree of diversification without using “Funds of Funds” approaches. These are expensive because they add additional layers of fees on underlying funds. By pooling assets for alternatives across the LGPS, funds would be able to substantially reduce the use of Funds of Funds.
- Less use of Funds of Funds for alternative assets and early elimination of high fee alternative assets could eventually save another £240m (13bps) **or more** per year. It is not possible to achieve this saving immediately since it will be necessary to:
 - a. establish suitable LGPS wide investment vehicles; and
 - b. allow existing investments to unwind year by year over the next decade to avoid early exit costs. Further savings might be possible at a later stage using in-house teams. This would require significant investment in specialist in-house resource but we believe this would be more than compensated by more effective implementation and additional fee savings.

How to achieve these cost savings

- All of the above cost savings could be achieved with minimal legislative change (e.g. requiring changes to secondary legislation governing investment limits). If the government chooses to use compulsion to maximise the benefits, there would be additional legal issues to consider.
- While the cost savings identified could be achieved without significant structural reform, asset pooling would be necessary to achieve the full potential of these cost savings and to enable higher levels of participation without which cost savings would be eroded.

Costs and benefits of structural reform

The three options for **structural reform** in the scope of this project were set out by DCLG:

- **Option 1: A single asset pool**

Under this option the 89 administering authorities would remain but there would be a single collective investment fund for all assets. Decision making on asset allocation and contribution strategies would remain with the 89 administering authorities. They would also continue to be responsible for their own liabilities, employer liaison and member administration.

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- **Option 2: 5 to 10 asset pools**

This option is the same as 1 except that there would be 5 to 10 collective investment funds (groupings beyond the scope of this report). The 89 administering authorities would remain. Each would be responsible for decision making on asset allocation and contribution strategies and for its own liabilities, employer liaison and member administration.

- **Option 3: 5 to 10 merged funds**

Under this option, the 89 separate LGPS funds would be replaced by 5-10 merged funds. Responsibility for assets, liabilities, deficit management, employer liaison and member administration would all transfer to the new organisations responsible for the 5 to 10 merged funds.

- These three options differ in terms of:

- a. local investment decision making (it is assumed that under options 1 and 2 local decisions on strategic asset allocation would be retained, but not investment manager choice or implementation style);
- b. cost savings (options 2 and 3 may not be optimal scale for cost savings from implementation of passive investment and asset pools for alternatives);
- c. implementation costs and timescale and payback period (option 3 is likely to cost most to implement and take longest); and
- d. legal issues (might be more complex for option 3, fund merger).

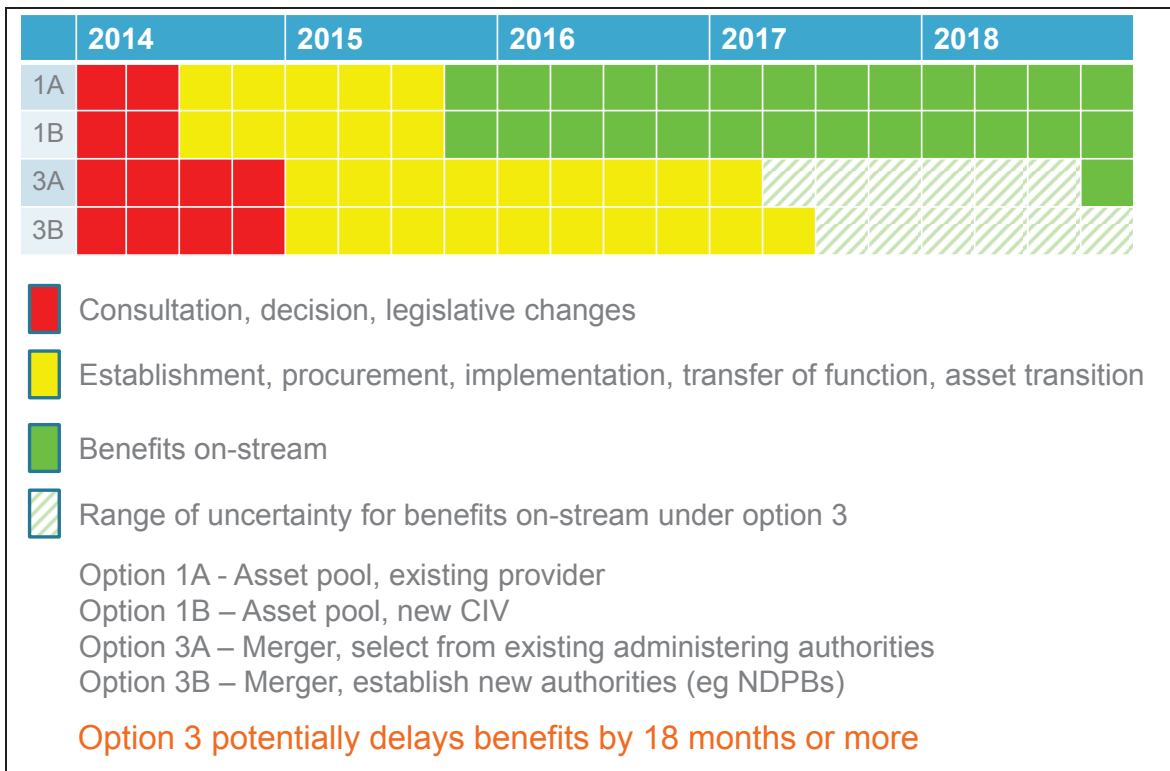
- Under Option 1, the net present value of savings is estimated to be circa £2.8bn over 10 years and £6.6bn over 20 years, based on:

- Full participation
- Using very large asset pools for passive investment
- Using LGPS wide asset pool to reduce the Fund of Funds investment for alternatives

These numbers take account of investment transition costs which will be paid out of the assets of the scheme. The numbers also take account of other operational costs of new arrangements, including set up costs for any collective investment vehicles and the associated ongoing monitoring and oversight arrangements.

- In addition the net present value of the savings over ten years from reduced transaction costs as a result of switching to passive investment in listed securities is £1.9bn. **Options 2 and 3** have similar benefits, slightly higher costs (although still modest relative to the cost savings) and longer payback periods. In the case of option 3, we have assumed it takes c.18 months longer to implement change. This delay reduces cost savings over 10 years by c.£0.7bn.

The picture below shows the implementation time-line for each of the options.



- The financial benefits quantified in the net present value measure in this report are most sensitive to the following factors, in descending order of significance:
 - 1 Participation/take-up;
 - 2 Extent of implementation – passive only or passive and alternatives;
 - 3 How early the changes are implemented;
 - 4 The level of fee savings on passive relative to current actual fees across the LGPS; and
 - 5 Scale of transition cost.
- The LGPS currently spends c£45m on investment oversight (this is twice the amount spent by large international peers). There might be modest additional cost savings in this area (e.g lower spend on advisers). Some of the savings could most appropriately be redeployed on internal resource for more widespread risk management including the greater amount of complexity resulting from the multi-employer nature of the LGPS (a feature not always present in the peer group).

A summary of the net present value of benefits is shown below.

Option	Net present value of benefits over 10 years	Net present value (10yrs) of active management transaction costs	Comments
1	£2.8bn	£1.9bn	<ul style="list-style-type: none"> Optimises benefits of pooling assets for passive and alternatives
2	£2.6bn	£1.9bn	<ul style="list-style-type: none"> Sub-optimal size for investment scale benefits (e.g. crossing benefits on passive and diversification on alternatives)
3	£1.9bn	£1.4bn	<ul style="list-style-type: none"> More complex legal issues to be resolved Could take significantly longer to implement, resulting in loss of cost savings Transfer of data and member administration from 89 funds to 5 or 10 makes implementation more onerous and more costly Combining member administration in this way may not be optimal approach Sub-optimal size for investment scale benefits Additional project implementation risk with little additional benefits

Other funded public sector schemes (stage 2)

- In practice it is likely to be extremely difficult to apply any similar approach to cost saving across those schemes, if it involves compulsion on investment choice, since they are governed by private Trust Law and there are greater legal barriers to be overcome. Voluntary participation in any asset pooling may deliver some benefits. The implementation approach for any agreed changes should be designed to make this possible.

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Conclusions and summary

The investment fee savings we identify are £470m p.a. In the table below we identify the breakdown of these savings. We estimate that the reduction in turnover cost in 2012-13 as a result of investing passively in listed equities would have been c.£190m.

Cost saving per annum	How	Timescale
£230m (12bps)*	More passive investment	Within two years
£240m (13bps)**	Lower cost alternatives	Full annual saving not achievable until Year 10
£190m (11bps)	Lower turnover	Post transition

* The cost saving equates to 15 bps of the value of listed securities, or 27bps of the actively managed listed securities

** The cost saving equates to 136 bps of the value of alternatives.

- There are a number of **conditions** for the delivery of the estimated benefits:
 - Legislative changes as required (e.g. secondary legislation on current investment limits).
 - Large (industry wide) asset pools to maximise scale benefits including crossing opportunities within passive arrangements.
 - Careful management of the transition to the new passive arrangement to minimise explicit costs and market impact costs (possibly a one-off LGPS wide exercise)
 - For Funds of Funds and alternatives, existing investments should be allowed to run their course to avoid incurring losses due to early redemption. All new investment would be made into new arrangements with lower implementation costs.
 - Full or widespread participation. Our estimates are based on full participation across the LGPS. It is a matter for government whether to use compulsion.
- The potential cost savings outlined above could be achieved with or without significant structural reform. However, asset pooling is necessary to deliver some of the potential cost savings fully (e.g crossing benefits in passive investment and more affordable access to alternatives) and may be helpful to enable high levels of participation without which the benefits could be lost.
- Next steps may include further consideration of legal aspects (especially if the government is considering compulsion) and practical details such as the most suitable and cost efficient types of vehicle for asset pooling (this may differ between passive investment and alternatives) and the mechanism by which the actual cost savings will emerge via employer contribution rates.
- These measures could **reduce LGPS investment costs by nearly a third** if the change to more passive investment is implemented and by **more than half once changes to alternatives work through**. Together the two changes could deliver savings of **£6.6bn over 20 years** if implemented effectively.

Scope, principles, limitations

Options in scope

In this report we consider three options for structural reform of the LGPS set out by DCLG.

Option 1: A single asset pool

Under this option the 89 administering authorities would remain but there would be a single collective investment fund for all assets. Decision making on asset allocation and contribution strategies would remain with the 89 administering authorities. They would also continue to be responsible for their own liabilities, employer liaison and member administration.

Option 2: 5 to 10 asset pools

This option is the same as 1 except that there would be 5 to 10 collective investment funds. The 89 administering authorities would remain. Each would be responsible for decision making on asset allocation and contribution strategies and for its own liabilities, employer liaison and member administration.

Option 3: 5 to 10 merged funds

Under this option, the 89 separate LGPS funds would be replaced by 5-10 merged funds. Responsibility for assets, liabilities, deficit management, employer liaison and member administration would all transfer to the new organisations responsible for the 5 to 10 merged funds.

Objective

The primary objective of this exercise is to identify (and quantify using the best currently available data and evidence) the most significant potential cost savings and to assess how they might most readily be achieved under the three options. A different objective would require a different approach to the assessment and analysis of the options for structural reform.

Clearly all cost savings are measured relative to the status quo.

Scope of report

The scope includes:

- quantification of current investment management costs (including investment management costs and turnover costs)
- identification (and quantification) of potential cost savings and the means by which they might most readily be achieved
- analysis of net of fees performance;
- estimation of cost of change (investment transition costs, cost of establishing new structures, future operational and oversight costs)
- cost benefit analysis of the three options; shape and timing of emergence of savings; payback period; annual cash savings and, since could be different under current actuarial practice, timing of high level implementation programme;
- emergence of benefits via contribution reductions; risks to benefits realisation; sensitivities on financials;
- practical and legal impediments to implementation (and benefits realisation); and
- high level assessment of the applicability of the options in scope to other (non-LGPS) funded public service schemes.

In benefits quantification, the focus is on “hard” data on cost reduction, rather than potential less easily quantifiable performance enhancements, including “governance premium”.

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The following are NOT in scope:

- a recommendation on which option should be taken forward;
- dealing with deficits;
- member administration; and
- quantification of any governance dividend under different structure.

We have not considered how liabilities are managed; however, we have made the assumption that each employer will remain liable for the financing of their own liabilities, so the number of “employer liability pots” will be the same irrespective of the option chosen.

Principles

In undertaking this project we have sought to adhere to the following principles:

- benefits quantification is evidence based, using the best data currently available;
- where there is no reliable, relevant evidence or data for benefits, this is not taken into account in the central scenario in the cost benefit analysis;
- our reporting is restricted to commentary and analysis based on data and evidence, not opinion (if there are any grey areas at the boundaries we distinguish between fact and opinion);
- we state any critical conditions for the delivery of any assumed benefits (e.g. the degree of participation);
- our analysis of legal barriers is based on our understanding of the law as it currently stands.

Reliances and Limitations

Our report is addressed to our client for this project, the Department for Communities and Local Government (DCLG), for the sole purpose of assessing the cost and benefits of three options for structural reform of the LGPS (and other funded public sector pension schemes) as set out in the scope above along with practical and legal impediments to change. It has not been prepared for any other purpose.

This report must not be shared with any other party without our prior consent and if shared must be disclosed in its entirety. We do not accept any liability to any third party.

The information in this report is based upon our understanding of legislation and events as at 12 December 2013 and we have used all reasonable endeavours to ensure the accuracy or completeness of the information contained herein. DCLG acknowledge that we have relied on data and legal advice provided by our partner organisations in compiling this report, CEM and Squire Sanders, both under sub-contracting arrangements. Whilst reasonable efforts have been made to ensure the accuracy of the data and advice expressed, we cannot verify the accuracy of such advice and data and we cannot be held liable for any loss arising from use and/or reliance on such advice and data.

It should be noted that we do not provide legal services and therefore, we accept no liability to any third parties in respect of any legal opinions expressed in this report. Third parties are advised to take independent legal advice in respect of any legal matters arising out of this report.

A number of other organisations provided data to assist the project; for the avoidance of doubt, those organisations not party the client agreement with DCLG are not in any way liable for data they have provided.

1 Cost assessment

Highlights

- Based on data from a sample of 18 LGPS funds who volunteered their data, total asset management costs across the LGPS in 2012 were estimated by CEM Benchmarking Inc at £790m (c.44 bps of total assets)
- Of this £745m was investment costs and of that c.£710m was paid to active managers
- Moving equities and bonds fully passive would reduce fees by c.£230m p.a.
- The cost of transitioning equities and bonds to passive is estimated to be c £215m, of which £47million is stamp duty on purchases of UK equities
- The reduction in turnover cost in 2012-13 as a result of investing passively in listed equities would have been c. £190m.
- Alternatives are less than 10% of total assets but account for 40% of total fees
- Management costs for alternatives could be significantly reduced by reducing/removing the use of fund of funds though this would take time to achieve due to the long term nature of the underlying contracts.

Total costs of managing the assets

In order to assess the total costs of the management of the assets of the LGPS and then identify where and to what degree savings can be made we have relied on analysis carried out by CEM Benchmarking Inc based on detailed information supplied voluntarily by 18 LGPS funds with total assets (as at 31 December 2012) of £38bn. This sample is representative of the LGPS by fund size; i.e. it represents small, medium and large funds in appropriate weightings. Table 1 below shows the breakdown by asset size.

The CEM analysis has identified the total costs and allocated them across asset classes down to a very detailed level and by implementation method (active vs passive, internal vs external, direct vs fund of funds). These realistic costs have then been applied to a fund size of £180bn with the actual asset allocation of the aggregate LGPS. Appendix 1A sets out the methodology applied by CEM and provides more detailed results from their analysis.

Table 1: Analysis of funds included in CEM investment cost benchmarking exercise

Fund size	All LGPS	Funds included
£5bn +	29.9%	23.6%
£2-5bn	35.1%	46.2%
£1-2bn	20.9%	19.4%
Less than £1bn	14.0%	10.7%
Total	100%	100%
Total Assets	£180bn	£38bn
Number of funds	89	18

Investment management costs

The CEM analysis at aggregate Scheme level extrapolates from the data provided by eighteen LGPS funds to estimate total investment management fee costs of £750m, equivalent to 41.5 bps of the assumed assets of £180bn. These costs include performance related fees on conventional assets but exclude performance-related fees on alternative assets. Turnover costs are also excluded.

Table 2 below breaks down these costs by asset class and by active and passive management.

Table 2 – investment management costs by asset class

Asset class	% of total assets	Active fees (£000)	Passive fees (£000)	Total (£000)	% of total fees
Equities	65.8	256,963	31,103	288,068	38.5
Bonds and cash	17.6	54,535	7,141	61,674	8.2
Property	6.8	97,996	0	97,996	13.1
Alternatives	9.8	300,883	268	301,151	40.2
Total	100.0	710,377	38,512	748,890	100.0

While this is a huge amount of money, the CEM analysis indicates that the LGPS as a whole is paying on average less than the peer group for active external investment management which makes up the bulk of the costs. The peer group would be paying £18m more than the LGPS for similar services. This reflects our experience that many funds have negotiated well with managers to bring their fees down. In particular, the data provided to CEM shows that LGPS funds are paying significantly less in fees paid for active management of their UK equities compared to that paid by the peer group; this may be at least partly influenced by the fact that the UK is the home market for LGPS funds. This differential is sufficient to reduce the total annual investment management fees paid by the LGPS by c. £50m. While there may still be scope to negotiate lower fees, the inevitable conclusion is that there is a limit to the benefit that can be secured by seeking further reductions in manager fees. It follows that, if costs are to be reduced significantly, other solutions have to be found.

The larger part of the fee burden suffered by the LGPS is for active management (£710m) which is significantly more expensive than a passive approach. Chart 1 (opposite) compares the allocation of LGPS fund assets with the fees paid to manage those assets. The chart highlights how cheap passive management of equities is and the disproportionate amount of the LGPS fee budget that arises from investment in alternatives. The management of active equities and bonds together account for £311m of fees. Alternatives account for less than 10% of the assets but for at least 40% of the fees (CEM’s analysis does not capture performance-related fees on alternative assets).

Chart 1: Total LGPS fund value and fee budget split by asset class



Reducing investment management costs

There are three key ways to reduce the costs of the investment management of the assets of the Scheme;

- 1 Reduce the level of active management in favour of passive – the fees for passive management are significantly lower than the fees for active management;
- 2 Reduce the layers of fees that are inherent in fund of funds arrangements which are common in the management of property and alternatives, and
- 3 Move more of the assets from external to internal management.

Reducing active management in favour of passive

In aggregate, the LGPS uses less passive management than the peer group of large funds in the CEM analysis. (The use of passive management by the 18 LGPS funds combined is higher than that of the peer group of funds in the £25-£45 billion size group. However, the very large global funds make more extensive use of passive management than both LGPS funds in aggregate and global funds in the size range up to £45bn).

Realistically passive management is only available on listed assets, i.e. bonds and equities where there are market indices which can be replicated using either physical stock or derivatives or ETF's. Based on the analysis of the data submitted to CEM, we estimate that there is potential to save up to £230m p.a. if all of the equities and bonds are managed passively. Over 80% of these gains (c£193m) is attributable to equities. While there would be costs involved in transitioning from the current actively managed portfolios to passive which we quantify below, the savings are relatively easily accessible.

Table 3: Estimated fees p.a. after moving all of equity and bond management to passive

	Fees (£000)	% of total fees
Equities (all passive)	95,217	18.4
Bonds (all passive)	23,089	4.5
Property (all active)	97,996	18.9
Alternatives (predominantly active)	301,151	58.2
Total	517,453	100.0

We consider in Chapter 2 of this report the potential impact on performance, i.e. the returns that may be generated from an asset structure which is predominantly passive compared to one that is managed actively. We have included a more detailed analysis of the fee savings achievable for listed securities by moving from active management to passive in Appendix 1B.

Reducing the layers of fees in fund of funds arrangements

The Scheme has more assets in fund of funds than the peer group. This is likely to be due to the relatively small size of the individual LGPS funds relative to the average size of the peer group. The fund of funds route has enabled the LGPS to diversify their exposure but comes with an additional layer of fees. We believe that there are significant savings to be achieved by accessing alternative assets more directly than the Scheme does at the moment. There is global research which identifies the reduced costs achieved by very large funds that invest directly into private equity in general and infrastructure in particular. CEM's analysis indicates that the higher use by the Scheme of fund of funds arrangements for investing in private equity relative to the global

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peer group adds c. £14m to investment management costs; the peer group still has a significant level of fund of funds exposure so there could be even bigger gains to be made than this figure indicates.

However we believe that the costs involved in 'dismantling' the existing fund of fund structures are likely to be extremely onerous and that the sensible approach would be to allow existing closed end funds to run off, while ensuring that any commitment is conducted differently / directly. Lower costs will be easier to achieve if we can identify some means of consolidating the assets of the Scheme that are allocated to alternatives, e.g. into a single entity, to access investment opportunities as cheaply and effectively as possible. We return to this below.

Moving assets from external to internal management

External active management tends to be much more expensive than internal or passive management. The Scheme uses more external management than the peer group. CEM's analysis indicates that the impact on the costs of the Scheme of using more external management than the global peer group is of the order of £57m of which c.£21m are associated with alternative assets. Research carried out by CEM¹ showed that the fee for an active EAFE (essentially global ex North America) equity mandate managed externally was over four times as much as an internally managed mandate (46bps v 10 bps).

Six of the 89 LGPS funds in England and Wales already manage a significant portion of their assets internally and qualify for inclusion in State Street's peer group of internally managed UK pension funds. (To qualify for inclusion more than two thirds of assets must be invested by in-house fund management team.) We consider the relative performance of internally and externally managed funds in Chapter 2.

Oversight, custodial and other costs

The CEM analysis indicates that if the experience of the 18 funds is extended to the whole Scheme, the LGPS is estimated to be spending c.£45m on oversight, custodial and other asset related costs. This includes consulting and performance measurement of c. £11.5m. CEM estimates that as a whole the LGPS is paying c £22m more than the peer group with c £9m of this being excess consulting and performance measurement costs. The balance of the excess cost is allocated to 'oversight'. Given that for the LGPS this represents the costs of 89 funds, each with similar oversight functions, against the cost of a single fund in the peer group there is an implication that reducing the number of entities required to oversee the investments could result in some savings and that this should be possible without compromising the quality of the oversight. (Alternatively the same expenditure might be applied in more effective ways through collaboration or structural change.) However the cost savings here are of second order magnitude compared to the potential savings in direct investment management costs.

¹ 'The World's Lowest Cost Funds, Herbert Lum, Research Director, CEM Benchmarking Inc, Oct 2006

Table 4: comparison of Oversight, Custodial and Other Costs

Activity	LGPS (£000s)	Peer Group (£000s)	Cost/savings (£000s)
Oversight	19,077	6,512	12,565
Custodial/trustee	9,881	9,881	-
Consulting /performance measurement	11,522	2,696	8,826
Audit	1,911	1,274	637
Other	2,542	2,839	-297
Total	44,933	23,202	21,731

Other costs of investment – turnover and transactions costs

All investment portfolios suffer transaction costs due to dealing in the underlying assets. Even a passively managed portfolio has some turnover due to changes in the constituents of the benchmark which will happen at regular intervals and the need to re-invest dividend income from the underlying holdings. The level of activity in an actively managed portfolio can be significantly higher and this has an adverse impact on costs. Not all transaction costs can be measured easily and accurately. There are explicit costs like broker commission and stamp duty which are measurable but other 'implicit' costs like the bid offer spread, market impact and opportunity cost are harder if not impossible to measure. Appendix 1C sets out more detail and definition of the components of transaction costs.

Table 5 below sets out the annual cost impact at the level of turnover of the market index for equities and the additional cost for incrementally higher levels of turnover.

Table 5: Turnover and transaction costs (bps)

Market	passive	excess cost relative to passive			
		25% turnover	50% turnover	75% turnover	100% turnover
UK	0.08	0.20	0.45	0.70	0.95
North America	0.01	0.06	0.14	0.21	0.29
Japan	0.01	0.14	0.29	0.44	0.59
Europe ex-UK	0.03	0.09	0.21	0.32	0.43
AP ex Japan	0.04	0.15	0.33	0.51	0.69
Emerging Markets	0.10	0.20	0.48	0.76	1.04

According to State Street, the average internally managed fund turns over a quarter of its UK equity portfolio each year while the All Funds Universe average is 46% p.a. If we apply the turnover that State Street identified for the LGPS in the 2012-13 year across both UK and overseas equities and compare this to the cost of turnover if all of the equities had been managed passively, the extra cost identified is of the order of £190m p.a. This assumes that the turnover in non-UK equities is evenly spread across all regions and comes with the

caveat that the costs of turnover vary by region. Due to stamp duty of 0.5% on purchases the UK is an expensive market in which to trade, beaten only by emerging markets. It should be noted that this analysis does not capture all the elements of implicit costs e.g. market impact. We estimate that market impact could add a minimum of a further 5 bp of total equity assets turned over to costs, i.e. an additional £56m p.a.. Table 6 below sets out the composition of the £190m.

While there might be some debate about the actual transaction costs incurred by managers, it is worth noting that the transaction levels in 2012-13 were lower than the average for the five years to 2013. Based on the average turnover for the five years to 2013, the £190m would become £240m assuming the same transaction costs.

Another element of transaction costs is generated by mandate turnover as funds replace managers who have underperformed. However the impact of these transactions is included in the turnover identified by The WM Company and cannot easily be separated. The procurement activity associated with mandate turnover generates additional costs but these are small in relation to the other costs of change.

Table 6 – estimated cost of turnover for LGPS equities

Market	One-way turnover %	Estimated transaction costs (bid/offer plus fees) %	Excess cost of active manager turnover	Asset allocation at 1 Apr 2012 %	Extra cost on £180bn (£000s)
UK	22.5	1.00	0.175	25.4	79,827
North America	34.5	0.30	0.092	10.8	17,881
Japan	34.5	0.60	0.199	3.4	12,202
Europe ex-UK	34.5	0.45	0.137	8.0	19,732
Asia Pacific ex Japan	34.5	0.72	0.215	3.6	13,908
Emerging Markets	34.5	1.12	0.308	5.2	28,871
Global	34.5		0.150	6.0	16,200
Total				62.4	188,621

Costs of turnover in government bonds will be significantly lower than in equities though the level of turnover is likely to be higher; State Street identify 45% one-way turnover in government bonds for the aggregate LGPS in 2012-13. Transaction costs in alternative assets are significant.

Investment management costs under status quo and alternative structures

Increasing the element of passive management

It would be possible to increase the proportion of the Scheme managed passively under either 'status quo' or any of the three alternative structures that this report considers.

The research we have done, as part of this project, on the passive management of equities leads us to the conclusion that there is a significant advantage to being an investor in a very large fund. The advantage comes from the reduction in frictional costs of trading either into or out of the passive pool of assets and from the regular rebalancing activity that is required. The managers of passive funds that we interviewed all described a process whereby flows of money either into or out of the passive fund benefit from a high degree of 'crossing'. Simply put, with a large number of investors with different behaviour patterns, at any dealing date there are likely to be both buyers and sellers. The first stage of deciding how to manage these transactions is to match

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the buyers and sellers as far as is possible at the unit level (e.g. one investor selling UK equity fund units and another investor buying). The next stage is typically to use the residual cashflow to carry out any desirable rebalancing to improve the tracking of the assets in the fund. After that there may still be further opportunities for matching at the asset level with transactions that are taking place for other clients. However the larger part of the crossing is done at the unit level, perhaps because the 'shape' of the trades, buys and sells, is a good match. The managers we interviewed cited crossing between 20% and 60% of cash flows at unit level and relatively modest levels, c 10%, of crossing at asset level.

Under the status quo the bulk of LGPS assets that are managed passively are invested in pooled funds managed by the three largest passive managers and therefore arguably already benefit from the unit crossing of a large fund. As an example of scale, Legal and General's UK equity fund is £42bn and the resources applied to the management of the firm's passive business include c. 20 investment managers.

Option 1 implications

If the passive investment of the 89 funds was in a pooled fund or funds (if more than one manager were employed) dedicated to LGPS then there is likely to be a reduction in the crossing opportunities as all of the investors are likely to have cashflows going in the same direction as each other. While the UK equity assets would amount to almost £46bn, there would only be about £6bn invested in each of Japan and Pacific Basin ex Japan if the current asset allocation were maintained across the Scheme.

Option 2 and 3 implications

The same issues, i.e. reducing the opportunities for crossing units, apply as for option 1 although, with even fewer LGPS participating in each collective investment vehicle (CIV), the chance of crossing opportunities would be even lower. Under the 5 fund scenario would be c £36bn, resulting in less than £9bn of assets in the UK equity sub fund and around £1.25bn each in Japan and Asia Pacific Basin ex Japan.

Under each of these two options the issue of scale might be addressed by either;

- The CIV(s) holding units in one or more of the existing pooled funds rather than investing on a segregated basis, or
- Agreeing an arrangement with an existing passive manager to set up a sub-fund within an existing fund specifically for LGPS investments.

There are a number of reasons why we do not believe that internal management can compete with the current external managers of passive funds;

- The low fees that currently prevail for passive management
- The value of the crossing opportunities that are available when there are different investors in the pool with varying cashflow patterns
- The significant costs of resourcing the activity effectively (e.g. L&G have a team of c 20 managers allocated to managing passive mandates)
- The track record the existing managers have of adding value relative to benchmark.

Reducing the layers of fees in fund of funds arrangements

The evidence globally is that it is only the very largest funds that invest directly into alternative assets using their own internal resources. This reflects the significant costs associated with the level of due diligence required to invest directly into private equity or infrastructure. Under options 2 and 3, even with only five CIVs, we do not believe that it would be practical to achieve adequate diversification for each £36bn fund through direct investment. We believe direct investment in alternative assets is only viable if the assets allocated are invested in a single and appropriately resourced collective vehicle.

Moving more of the assets from external management to internal management

A study by CEM² showed that on average six front office investment staff were required for every US\$10billion (£6bn) of assets managed internally. State Street³ report that the internally managed LGPS funds employ teams that range in size from 8 to 22 with an average of 13. The largest of the internally managed LGPS funds is c. £10bn so LGPS staff numbers look quite large. State Street suggest that this may be because the LGPS funds are small relative to the funds in the CEM study (average US\$90billion). However, our discussions with a number of the internally managed funds suggest that these figures probably include the 'back office' and accounting staff. CEM found that for every one front office investment member of staff there were 1.7 staff members engaged in governance, operations and support. Under the 5 fund model in options 2 and 3, this would imply 36 front office staff and 60 back office staff for each of the 5 asset pools or merged funds if all of the assets were managed internally. However these staffing requirements would be reduced if the listed assets were managed passively.

Transition costs – increasing the element of passive management

While it is clear that, once in place, passive management of the equities and bonds would be cheaper than active management there are costs involved in the transition. In order to quantify these costs we designed a hypothetical transition. This involved moving all of the listed equities and bonds that are currently managed actively (apart from the small elements that are currently managed internally) to passive management.

The total costs of transition are estimated as c.£215 million. It should be noted that c.£47 million (22%) of the estimated transition cost is UK Stamp Duty on the purchase of UK equities involved in the reorganisation.

The cost estimate for transition assumes that implementation is carried out as a single co-ordinated exercise. The process and timescale for the transition is designed to minimise costs. The volume of trades involved will require multiple tranches of transitions to avoid high market impact costs.

Appendix 1D provides more information on transition methodology and the estimated costs.

² 'How Large Pension Funds Organize Themselves', Jody MacIntosh and Tom Scheibelhut, Spring 2012

³ Lessons from Internally Managed Funds, March 2013

2 Performance impact of changes in asset management

Highlights

- While some funds have a good and consistent performance, there is no evidence that, in aggregate, the Scheme has outperformed regional equity markets over the ten years to 2012-13
- This is consistent with both UK and global evidence which suggests that any additional performance generated by active investment managers is on average insufficient to overcome the additional costs of active management
- There is evidence that internally managed pension funds in the UK have outperformed those with no internal management even before fees are taken into account
- However, global evidence suggests that the lower cost of internal management is the main reason for the outperformance of funds that have more internal management.

Methodology

In this chapter we examine the potential for the changes in the management of the assets to impact on the investment performance. We have examined published research that provides evidence on UK and Global pension funds. For LGPS specific data we have used two sources of data;

- 1 Our proprietary database of LGPS fund performance which records for each fund, performance at total asset level for each the eight financial years from 2005-06 to 2012-13. This database has been built up over time by sourcing data from the published Annual Reports. It forms the basis for Table 10 below.
- 2 Data supplied by State Street Investment Analytics detailing the returns by asset class at the aggregate Scheme level for each of the 10 years from 2003-05 to 2012-13. This information is summarised in Appendix 2a and forms the basis for Table 9 below.

The LGPS investment model

The most common model for the management of the assets of an LGPS fund is a combination of active and passive management with external managers being hired to manage all of the assets. Those funds that have made allocations to alternatives, specifically hedge funds, private equity and infrastructure, have used a significant level of fund of funds structures. Some of the property exposure also incorporates funds of funds to get adequate diversification. A number of funds have some element of internal management (most commonly passive equities) but only six qualify for inclusion as internally managed under State Street's definition which requires over two thirds of the assets to be managed in-house.

There is a significant cost differential between active and passive management as we have shown in Chapter 1. Active management is selected on the assumption that the manager will outperform the benchmark by more than the additional cost of investment. The focus on what the extra cost is has been on the element that relates to manager fees. However, as we demonstrated in Chapter 1, there is an additional drag on active performance from the higher levels of turnover that active managers undertake. The impact of transaction costs is included but hidden in the reported performance. Although managers are required to make disclosures on the costs they incur, it is impossible to identify the full impact of trading costs.

Comparison of performance of active v passive management

UK evidence

State Street Investment Analytics published their most recent analysis of Active and Passive Management in July 2012. In the report, they 'consider the ranges of risks and returns for passively and actively managed equity portfolios of UK pension funds relative to broad market indices.'

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Table 7 below shows the ten year returns by equity market for the passive and active equity portfolios of UK pension funds. The passive portfolios have, as expected, closely tracked the appropriate indices; the weighted averages for all regions are within 0.2% of the index return. The record of the actively managed portfolios shows a range from an outperformance in World Pacific ex Japan of 0.9% p.a. to an underperformance of 1.1% p.a. in North America.

The returns quoted do not take account of investment management fees.

Table 7: Ten years to end 2011: Index and Weighted Average Returns (% p.a.) (Gross of fees)

Equity market	UK	North America	Europe ex UK	Japan	Developed Pacific ex Japan	World Pacific ex Japan
FTSE Index	4.8	2.8	4.3	2.5	12.1	10.9
Passive Portfolios	4.8	2.6	4.3	2.6	12.2	-
Active Portfolios	4.9	1.7	4.5	2.0	11.8	11.8

Global evidence

Research based on the asset allocations of US defined-benefit pension funds for the period 1990-2008 tested the role of three factors, market movements, asset allocation policy and active portfolio management, in explaining their returns. The results are reported in 'Rehabilitating the Role of Active Management for Pension Funds' by Michel Aglietta, Marie Briere, Sandra Rigot and Ombretta Signori. Table 6 below summarises their findings.

Table 8: decomposition (%) of pension funds' actual net returns 1990-2008 (Net of fees)

Factor	Global Allocation	Stocks	Fixed Income	Cash	Real Assets	Hedge Funds	Private Equity	TAA
Market*	90	96	70	26	47	54	26	75
Asset allocation	4	2	3	13	2	2	2	5
Active Management	2	0	20	36	40	40	54	16
Interaction effect	4	2	7	25	11	4	18	4

*Market returns are defined as average returns of all pension funds

While the performance of traditional asset classes is driven mainly by market movements and active management makes little impact, active management plays a significant role for the alternative asset classes, particularly real assets, hedge funds and private equity. For equities, 96% of the return volatility is explained by market movements, 0% by active management and 2% by policy allocation. For real assets, market movements account for only 47% of performance while active management accounts for 40% highlighting the potential to add value through asset selection due to the heterogeneity of performance.

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LGPS evidence at aggregate Scheme level**Data from State Street Investment Analytics (The WM Company)**

A number of LGPS funds have a good and consistent record of investment performance over long periods. However this is not replicated across the Scheme. In this section we consider the performance that has been achieved within equities (broken down into regions) and bonds. We do not consider the contribution from asset allocation.

We have examined the data for the aggregate LGPS (including Scotland and Northern Ireland) for the ten year period ending on 31 March 2013.

Table 9: Ten years to 31 March 2013; Index and weighted average returns (% p.a.) (Gross of fees)

Equity market	UK	North America	Europe ex UK	Japan	Developed Pacific ex Japan	Emerging Markets
FTSE Index	10.7	9.5	11.4	7.4	16.4	18.2
Aggregate LGPS	10.8	8.4	11.6	7.5	17.3	17.1
Excess active return	0.1	-1.1	0.2	0.1	0.9	-1.1
Extra cost (p.a.) of active	0.34*	0.27	0.20	n/a	0.49	0.53

Sources: State Street Investment Analytics (The WM Company), CEM Benchmarking Inc.

*this is our estimate of the extra cost which reflects the low fees that the LGPS in aggregate pay for active management of UK equities. The global cost premium is estimated by CEM as 0.56%

Appendix 2A includes detailed analysis of performance across equities and bonds broken down into different time periods. Although some periods show stronger performance than others, there is no strong evidence that the aggregate Scheme has outperformed the market in the long term.

The funds' aggregate equity returns and the funds' regional equity returns are highly correlated with the broad market index. Correlation data provides an indication of the strength of the relationship between the funds' returns and the underlying index returns. It does not provide any information on the scale of the relative moves. For example, even the returns of a very active equity manager are likely to be highly correlated with the broad market index, typically in excess of 0.8. The correlations observed at aggregate Scheme level in equities are well in excess of 0.9 which reflects the high degree of overlap between the fund and the index holdings. Considering performance at the aggregate Scheme level masks the extent of the dispersion of returns across the funds.

Analysis based of Hymans Robertson's data

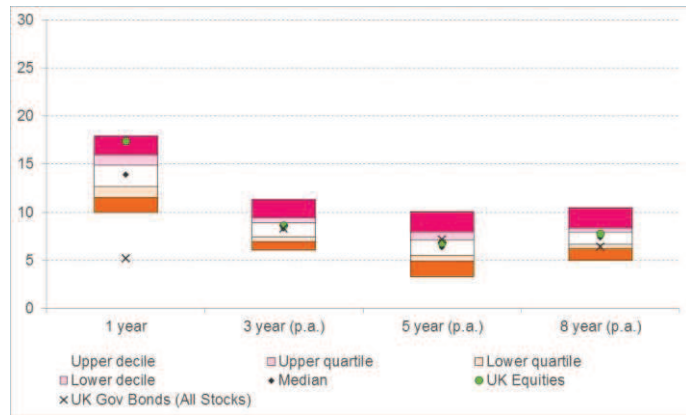
We have gathered the performance data for each of the LGPS funds at aggregate fund level over the eight years to 31 March 2013 and analysed it for each annual period and over the longer term. The difference here is that we are able to track the performance of each individual fund. Table 10 overleaf shows in tabular and graphical form the dispersion of returns over 1, 3, 5 and 8 years and for reference plots the returns for UK equities and UK government bonds over the same periods. Over 8 years the best performing fund has returned 5.5% p.a. more than the worst performing fund. Our analysis shows some evidence of funds with both consistently good and consistently poor performance.

In Appendix 2B we have included some further analysis by fund size. That analysis shows that there is no strong evidence that larger (>£1bn) LGPS funds have performed better than smaller funds (<£1bn) though there

is evidence that the performance is more widely dispersed for the smaller funds. This is counter to global research on the performance of large funds relative to small funds and may reflect the small sample size and the fact that even the largest LGPS fund is small in the global context.

Table 10: Dispersion of returns for LGPS funds over 1, 3, 5 and 8 years to 2012-13

	1 yr	3yrs (p.a.)	5yrs (p.a.)	8yrs (p.a.)
Maximum	17.9	11.3	10.1	10.5
Upper quartile	14.9	8.9	7.1	7.9
Median	13.9	8.3	6.4	7.4
Lower quartile	12.6	7.4	5.5	6.7
Minimum	10.0	6.0	3.3	5.0
UK equities	17.4	8.6	6.8	7.8
UK gov. bonds	5.2	8.3	7.2	6.4



Comparison of internal versus external management

UK evidence

State Street Investment Analytics monitor the performance of 21 funds that manage more than two-thirds of their assets internally using an in-house fund management team. The analysis was last performed on data as at end December 2011 when the funds were valued at £174bn. The average size of the internally managed funds was £8bn; four funds were valued at less than £1bn. Six of the funds that were included were LGPS funds and their total assets amounted to £17bn.

Table 11: Performance of internally managed funds (%p.a.) to the end of 2011 (before fees)

	5 yrs	10yrs	20yrs	25yrs
Internal	3.7	6.2	8.6	8.9
All Funds	3.5	5.9	8.3	8.6
Relative	0.2	0.3	0.3	0.3

As the cost savings from using internal management are significant, the differential performance after costs are taken into account will be even more substantial.

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Global evidence

Research by CEM⁴ showed that funds with more internal management outperform funds with less at the total fund level. On average, funds earned 4.6 basis points more net value added for every incremental ten percent of internal management. The lower cost of internal management was the main reason for the differential.

Further research by CEM⁵ examined the differential in performance between internal and external management at the asset class level. They found that before costs there was no statistically significant difference in gross value added performance between internal and external management at the asset class level. However, after costs were deducted internal management performed better than or equal to external management in all asset classes considered and there was a statistically significant difference in the performance of internally managed global non-US developed market equities (EAFE) of 96 basis points of net value added. Table 12 below summarises the results.

Table 12: Higher (lower) value added for internally managed assets in bps

Asset class	Gross of costs	Net of costs
US Stock	(23)	0
EAFE Stock	57	96
Emerging Markets stock	(32)	28
Fixed Income	(15)	0

The findings were consistent across country of domicile for the funds and across fund sizes in excess of \$20billion and those less than \$20billion.

Internal management in the LGPS

We have identified five LGPS funds each of which would qualify to be included in the State Street Investment Analytics peer group of funds that are managed internally. Table 13 overleaf summarises their performance relative to the universe of LGPS funds over the eight years to 2012-13 and relative to their own benchmarks over ten years. While these funds have done well relative to their peer group they have not all managed to beat their benchmarks which provide a measure of what would have been achieved through passive management.

⁴ **Internal Management Performed Better, Hubert Lum, December 2007**

⁵ **Internal management does better after costs, Terrie Miller and Chris Flynn, October 2010**

Table 13: LGPS Funds with internal management

Fund	Total assets as at 31 March 2013 £bn ¹	Performance % p.a. 8 years to 31 Mar 13 ²	Rank over 8 years ²	10 year Fund performance % p.a. ¹	10 year Benchmark return % p.a. ¹
Derbyshire	3.1	8.1	19	9.9	9.6
East Riding	3.1	7.9	29	10.1	10.2
South Yorkshire	5.3	8.3	12	9.9	9.9
Teeside	2.9	8.5	7	10.2	9.4
West Yorkshire	9.9	8.3	10	10.2	n/a

Sources: ¹Fund Annual Reports 2012-13, ²Hymans Robertson database

As part of our research for this project we interviewed three out of these five funds to find out more about how their internal arrangements work and their investment philosophy. A key characteristic which is borne out by global evidence was low turnover at both stock and mandate level and indeed one cited the low turnover as having added 20-25bps to performance.

Impact of reducing the use of fund of funds

Implementation using fund of funds results in high costs and this has an inevitable impact on performance. Research by CEM highlights that the fund of funds style of investing under-performed direct internal investing by 6.8% for private equity (1996-2012), by 5.5% for property (1995-2012).

Table 14: Average value added (%) relative to customised investible benchmarks* by implementation style

Asset Class	Internal	Direct Limited Partnership	Fund of Funds
Private Equity	6.2	1.8	-0.6
Real Estate	0.7	-1.1	-4.8

* The investible benchmarks use a mix of public market equity and REIT indices that varies by region. The benchmarks are custom-lagged for each fund. The real estate benchmark is adjusted for the higher leverage of public indices.

The fees disclosed for these alternative asset classes are frequently understated. The three most common reasons are:

- Management fees are frequently reduced by revenue sharing (commonly called rebates)
- Carry (e.g. performance fees) is excluded
- For fund of funds, the costs of the underlying funds are excluded.

3 Financial analysis

Highlights

- Moving all of the equities and bonds to passive management will produce fee savings of c £230m p.a.
- Reducing the use of fund of funds and removing very high cost alternatives will produce further fee savings of c £240m p.a. though the full annual saving will not be achievable until year 10
- The cost of transitioning the equities and bonds to passive management is estimated at £215m
- These are the elements that have the biggest impact on the calculation of the net present value of the savings. The additional costs, e.g. establishing, operating and overseeing collective investment vehicles, are relatively insignificant, although we have taken them into account,
- The financial benefits are most sensitive to the following factors in descending order of importance
 - The participation or take-up rate (i.e. how many of the LGPS funds decide to invest through the pooled approaches)
 - The extent of the implementation of the changes – passive only or passive and alternatives
 - How early the changes can be made
 - The level of the savings on passive relative to current actual fees paid across the LGPS
 - The scale of the transition cost
- The net present value calculated over ten years varies by option; Option 1 £2.8bn, Option 2 £2.6bn and Option 3 £1.9bn

Overview

The financial analysis is based on two components, relating to the change of investment approach:

- The costs involved in undertaking the change; and
- The benefits arising over time from the changes which result in lower manager fees. In relation to benefits, the basis we have employed is to evaluate benefits in a relative sense, i.e. the difference between the new fees and the fees currently being paid by the LGPS in aggregate

The financial plan takes account of the incidence of both costs and benefits. Our analysis in Chapter 2 showed that there will be no meaningful impact on the returns generated under the new investment approach.

Accordingly, we have made no allowance for either higher or lower investment returns.

Administration services are out of scope for this project. We have therefore excluded any assessment of potential future cost savings from re-organisation of administration services, under all three options.

Costs

The principal costs are:

- Establishment costs, e.g. the costs of specialist operating resource (personnel, support and infrastructure, including IT) for any new entities that are created. We have assumed a fixed cost of £500,000. It may be possible to use private sector partners in this area to contain costs.
- The cost of a dedicated investment management team for the collectivised alternative assets. We have made assumptions as to the initial size and quality of the investment team and allowed for this team to

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grow in the years following establishment. An allowance has been made for the costs of office space, IT and other support services. This element of our assumptions was 'sense checked' against the actual experience of IFM Investors who have extensive experience of investing in alternative assets. IFM was established over 20 years ago and is owned by 30 major not for profit pension funds.

- Costs relating to the creation of collective vehicles. This will depend on the number of vehicles and their structure, e.g. different approaches might be required for listed securities and alternative assets. We have assumed a cost of £300,000 for a listed securities vehicle and £780,000 for an alternative assets vehicle.
- Contractual adjustment costs relating to procurement of new agents that are necessary and any penalty costs relating to the terminations of contracts of existing agents. Because notice periods are short (typically 3 months or less), we do not believe there to be any material termination costs.
- Project management, actuarial advice (for option 3) and legal costs.
- Transition costs relating to the direct and implicit costs involved in restructuring assets. This is the dominant cost element and essentially relates purely to the listed asset component. Much of the investment in alternative assets is held in closed-ended funds which would be expensive to exit early. Consequently, we have assumed that existing investments in closed-ended funds will be maintained and allowed to run off. However, we envisage that new investment in alternatives would adopt a different structural approach.

Benefits

The principal benefits arise from:

- A switch from active to passive management for listed assets, which results in a significant saving in fees. We have used the data set out in Chapter 1 of this report.
- A gradual shift in the management of an element of alternative assets, from a fund of funds approach to a direct or funded approach. The benefit comes from the removal of an additional layer of fees, although the fact that the closed ended funds are allowed to run off means that the benefit comes through gradually. We have assumed the run-off takes place evenly over a 10 year period.
- The early closure of high fee contracts, where termination is straightforward (without penalty) and where the value of the product is of questionable value (in an aggregate LGPS context). This benefit amounts to c. £100 million p.a.; we have assumed that it will start to emerge 12 months after the decision to proceed is taken.

Time period

Our approach enables us to model the incidence of costs and benefits quarter by quarter. We modelled the first 10 years and the next 10 years. We have used a discounted cash flow basis to calculate the net present value (NPV) of the aggregate saving (benefits less cost) over the first 10 years of the project.

A key assumption for the purpose of quantifying benefits is the implementation timeline, including assumptions as to when costs will be incurred and when benefits will start to emerge. More detail on implementation plans and timelines is given in Chapter 4. For consistency, net present value calculations for all options have been calculated as at 1 January 2015. We have assumed this is the date when the decision is taken regarding the option which is to be adopted.

For the purpose of financial modelling, central assumptions in the net present value calculation include the following:

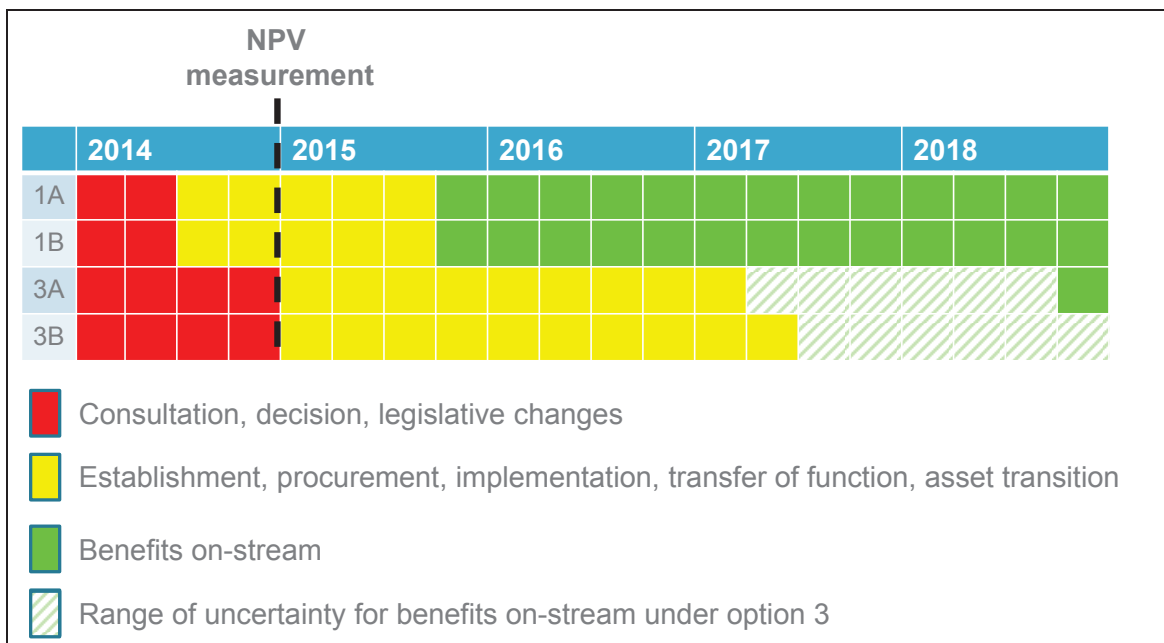
- 1) Under options 1 and 2, cost savings from the switch to passive investment come on-stream in Q4 2015;

- 2) Under option 3 (fund mergers), there is an 18 month time lag relative to options 1 and 2. Cost savings are assumed to start emerging in Q2 2017.

We expect the transition to new operational arrangements to take longer for option 3 (fund merger) because of the additional work and complexity involved in transferring membership data and records, member administration and liabilities, particularly if new administering authorities are established. There is also greater uncertainty in our timeline estimates for full fund merger due to greater uncertainty over legal impediments.

In practice the time lag could be greater than the assumed 18 months, in which case our estimate of the NPV of benefits under option 3 (over a 10 year period measured from 1 January 2015) could be an overstatement. On the other hand, even under option 3, the switch to investing passively (using asset pooling across the LGPS) could be implemented before fund merger, so the cost savings could emerge sooner.

The following graphic shows the incidence of various aspects of the project for structural change.



Other financial assumptions

- Initial value of the assets - £180bn
- Asset growth rate – 6% p.a.
- Discount rate – 5.5% p.a.
- CPI assumption – 2.5% p.a.

Risk to savings delivery

The principal risks to delivery of the savings will arise from:

- A take up of the new structure which is lower than modelled or in which the take-up comes through more slowly
- Time delay, i.e. if implementation is held up
- Greater transition costs than modelled.

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Sensitivity to assumptions

Participation/take-up

Assuming there is no compulsion, the assumption relating to the extent of participation in the new investment structure has a significant impact on the savings that can be anticipated. We have tested the impact of 100%, 50% and 10% participation. With lower participation, the cost of transition will reduce and this has been reflected in our modelling. However the costs of creating collective vehicles and the establishment costs are unlikely to reduce.

While, as we have observed earlier in this report, the impact of turnover and transaction costs in active portfolios is already reflected in the reported performance numbers, we have indicated the incremental impact on savings of this element of cost for each level of participation.

Costs

The largest element is the transition cost, which for a full transition to passive management has been estimated to amount to £215 million. This assumes that, after consolidating listed LGPS assets and identifying the portion to be traded, the transition is managed over a period of time rather than being achieved in a 'big bang' approach. Approximately £47 million reflects UK stamp duty on the buy side of the UK equity transition. We have tested the impact of the transition cost being 10% and 100% higher than estimated. This latter figure represents something close to a 'big bang' approach.

We have indicated the sensitivity of the savings to the option adopted, allowing for the additional costs involved for options 2 and 3 of having five collective investment vehicles rather than one. Additionally we have modelled a delay of 18 months in implementation for option 3 due to the additional legislation that is likely to be required.

Benefits

The major element relates to the fee reduction arising from the change from active to passive management on quoted equities and bonds which amounts to approximately £230 million p.a. in current cost terms. A change in the approach to the management of alternatives results in the gradual emergence of savings of approximately to £1.1 billion over 10 years assuming 100% participation.

We have modelled our central assumption of £230 million p.a. savings and savings £30m higher and lower. We have estimated figures for all 3 of the options.

Observations

- The level of take-up will have a significant impact on the savings achieved
- The extent of the implementation, i.e. whether the alternatives are restructured as well as moving the traditional assets to passive, is likely to have the next most significant impact
- In contrast a variance in the cost of the transition to, or the fees paid for, passive management will have a more limited impact.

Summary results - Comparative savings over 10 years**Table 15: sensitivity to take-up/participation – option 1 assumed**

Take-up	Savings in manager fees		Manager fees and transaction costs
	Passive and alternatives £bn	Passive Only £bn	Passive only £bn
100%	2.8	1.7	3.6
50%	1.4	0.8	1.8
10%	0.2	0.2	0.3

Table 16: sensitivity to DCLG options (1, 2 and 3) and transition costs – assumes 100% take-up

Transition cost assumption	Option 1 (one passive CIV, 1 alternatives CIV) £bn	Option 2 (5 passive and 5 alternatives CIVs) £bn	Option 3 (5 passive and 5 alternatives CIVs with 18 month delay in implementation) £bn
£215m	2.8	2.6	2.0
£240m	2.8	2.6	2.0
£400m	2.6	2.4	1.8

Table 17: sensitivity to DCLG option and level of passive fees – assumes 100% take-up

Assumption for savings from passive fees	Option 1 (one passive CIV, 1 alternatives CIV) £bn	Option 2 (5 passive and 5 alternatives CIVs) £bn	Option 3 (5 passive and 5 alternatives CIVs 18 month delay to implement) £bn
Central assumption - £230m across equities and bonds	2.8	2.6	2.0
Lower savings on passive - £200m	2.5	2.2	1.7
Extra savings on passive - £260m	3.2	2.9	2.3

4 Implementation project plans

Introduction

In this chapter we set out high-level implementation plans for establishing and managing a collective investment vehicle (options 1 and 2) and for fund merger (option 3). More detailed plans can be made available.

Assumptions specific to establishing CIVs (options 1 and 2)

- We have made some specific assumptions.
- DCLG is shown in the project plan in relation to the current project. We have assumed the involvement will relate to a preferred collective investment option. The period may be extended to allow for consultation. It is not clear to what extent activity will be conducted by other groups while the consultation proceeds.
- We have assumed there will be a “managing entity” which will direct activity around a collective vehicle. Because this will involve management activity over and above investment management, we have assumed that the managing entity will not be the direct “operator” of the collective investment vehicle, but will have a subsidiary company which will be the operator; this assumes that the managing entity will have “control” of the operator, rather than using a third party operator. The operator will need to be regulated by the FCA, which is the reason for setting it up as a subsidiary of the managing entity. Other activities conducted by the managing entity include:
 - Producing promotional and other material for potential CIV investors, i.e. LGPS funds
 - Reporting to and communicating with investors, both in relation to investment management activity, but also discussing aspects such as range of investment options, fee discussions, performance reporting
 - Monitoring the activity of the operator
 - Monitoring the activity of CIV providers (managers, custodian, etc.)
 - Assisting with resource, e.g. human resource function, IT, administrative personnel, offices accommodation, compliance, etc.
 - Assisting with procurement.
- We have assumed that a steering group will be established as a predecessor to the managing entity. This could be formed of a committee set up by a group of established administering authorities. The steering group would conduct preliminary investigations around the architecture of the collective vehicle. The managing entity is essentially a legal formation set up to continue the activity initiated by the steering group. The precise legal form of the managing entity is not defined – it might be formalised within an existing entity which collaborates across administering authorities.
- In order to establish the collective vehicle, both the operator and the vehicle itself will need (FCA) authorisation. The managing entity is likely to be a ‘qualifying parent undertaking’ under Part 12A of FSMA. The FCA has powers to oversee and give directions to the parent of an authorised person if that parent is not itself authorised.
- We have assumed that there will be a pilot transition of assets into the CIV, e.g. a single asset class transition could take place, as a live test of processes, prior to building out a wider group of sub-funds. This might not be consistent with a major transition to passive investment, which is likely to be more effective (in terms of speed and transition cost) if conducted in a single step.
- The actual project plan will depend on the specific architecture within the collective vehicle, so elements of the plan will change to accommodate specifics.

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- We outlined implementation plans for two scenarios:
 - Under 1A we assume that an **existing provider** is procured – there may be savings in the establishment costs and timescale but any time saving may be offset by the required length of the procurement process;
 - Under 1B we assume that a **new vehicle and operator** are established as described above.

Fund merger (option 3)

- We considered two scenarios:
 - Under 3A, we assume that **existing administering authorities** are selected to run the 5 merged funds. This may reduce the time taken to establish and make operational the new arrangements. However, time must be allowed for a transparent and rigorous selection process.
 - Under 3B we assume that **new agencies** are established to run the merged funds. These may be some form of Non-Departmental Public Body (NDPB). It may take any new agencies longer to become operational since they will need to procure property, staff, systems and external services and establish and test their own operational procedures and controls before the process of transfer from existing administering authorities can commence.

For fund merger (3A and 3B) in addition to transferring assets, the implementation will include transfer of all functions associated with the running of an LGPS fund including member administration, employer liaison, in-house investment monitoring and management and governance arrangement. This is a complex exercise and is likely to take significantly longer to implement. We assume that this activity is over and above the structural changes that might be implemented on the investment management side since the 5 merged funds will need access to asset pools to achieve cost savings on investment management (the primary focus of this research).

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Key stages

The table below sets out the main stages involved in each of the options. The detailed plans behind these stages can be made available.

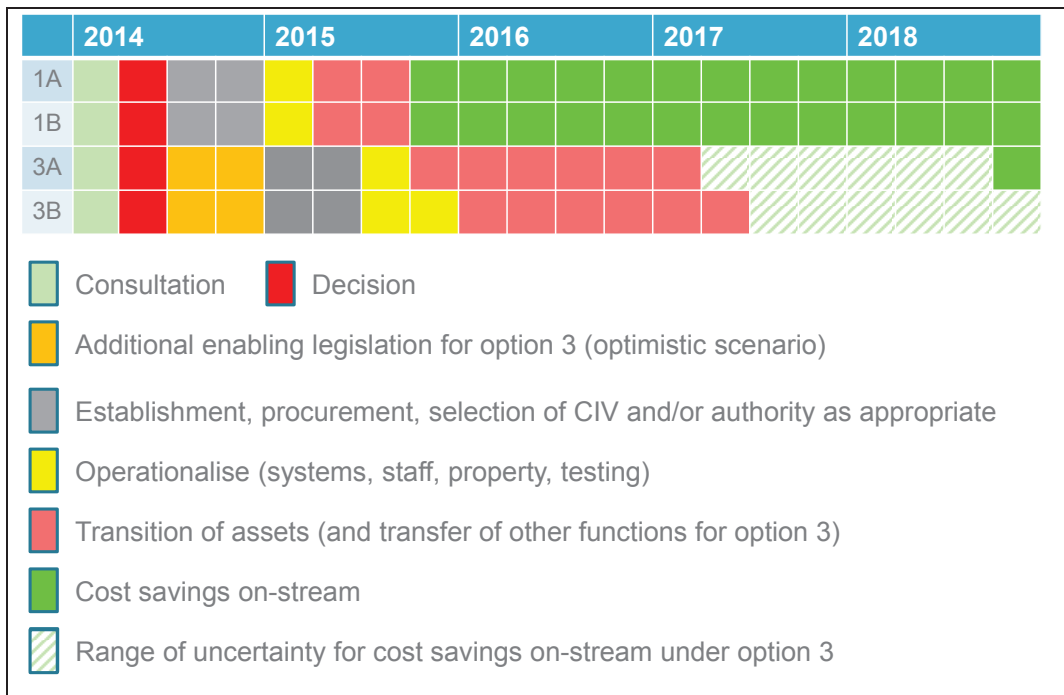
Table 18: Key stages and elapsed time from January 2014

Option	1A Asset pooling Existing provider	1B Asset pooling New vehicle and operator	3A Merger 5 existing authorities	3B Merger 5 new authorities
1) Consultation	3m	3m	3m	3m
2) Assessment of consultation responses; government decision	3m	3m	3m	3m
3) Legislation changes	N/A (c.6m but in parallel with 1) and 2)	N/A (c.6m but in parallel with 1) and 2)	6-18m	6-18m
4) Specify requirements for new entities	N/A in parallel with legislation	N/A in parallel with legislation	N/A in parallel with legislation	N/A in parallel with legislation
5) Establish new vehicle / authorities or select from existing	6m (procurement)	3m (select)	6m (selection process)	6-12m
6) Operationalise (infrastructure, controls, procure IT for administration, staffing)	3m	6m	3m	6-12m
7) Transition (assets) and transfer (liabilities and member admin)	6m	6m	18-24m	18-24m
8) Benefits start to emerge	21 months (Q4 2015)	21 months (Q4 2015)	Between 39 and 57 months	Between 42 and 72 months

High level comparison of timelines

The illustration below compares timelines for options 1A, 1B, 3A and 3B.

- Option 1A - Asset pool, existing provider
- Option 1B – Asset pool, new CIV
- Option 3A – Merger, select from existing administering authorities
- Option 3B – Merger, establish new authorities (eg NDPBs)



Conclusions

Clearly asset pooling (options 1A and 1B) can be effected considerably more quickly. There is a greater degree of uncertainty over implementation timescales for fund merger (option 3) – possibly in the range 3 to 6 years from January 2014 - depending on the implementation approach and the time taken to resolve legal aspects.

For financial modelling of cost savings we have assumed there is a timelag relative to options 1 and 2 of at least 18 months before cost savings from option 3 (merger) come on-stream.

5 Practical impediments to change and mitigation

Background

The main impediments to change relate to:

1. The level of adoption for any new structure or change in investment approach designed to reduce costs, i.e. obtaining “buy in” or creating statutory powers to compel;
2. Difficulties around new implementations arising from Schedule 1 limits within the current LGPS Investment Regulations;
3. Delays arising from any need for new entities to be established;
4. Delays or difficulties arising from funding and resourcing any new entities with required skills;
5. Project risk in relation to the restructure; and
6. Whether costs of the restructure will exceed benefits that can be achieved over a reasonable time frame or any lack of certainty over the potential scale of benefits.

Some of these impediments apply to each of the three options under consideration, for example, the current Schedule 1 limits (2 above). The impact of items 3 and 4 above may differ between one option and another.

Practical impediments to change

Issue	Resolution
Making the change There are risks and costs relating to the change in structure.	
<ul style="list-style-type: none"> The opportunity for other means of cost saving is foregone while new entities and vehicles are being established 	<ul style="list-style-type: none"> Formal planning will minimise delays. Some other opportunities may continue
<ul style="list-style-type: none"> The project may take longer than expected or may be implemented poorly 	<ul style="list-style-type: none"> Formal planning will minimise delays and risks of poor implementation
<ul style="list-style-type: none"> Provider contract termination penalties may add to costs 	<ul style="list-style-type: none"> Notice periods are short, but a full assessment would be required
<ul style="list-style-type: none"> Procuring providers will add delay and cost 	<ul style="list-style-type: none"> This will depend on the structure used and the parties procured
<ul style="list-style-type: none"> Who will bear the costs of change? 	<ul style="list-style-type: none"> The charge will be against assets (see estimate)
<ul style="list-style-type: none"> Transition will have an impact on markets 	<ul style="list-style-type: none"> Unlikely if well planned and phased
<ul style="list-style-type: none"> Transition costs may be significant (or higher than envisaged) 	<ul style="list-style-type: none"> Should have large retained assets and low disruption. Significant existing security turnover will be suspended. The saving in normal turnover cost will offset transition cost. Existing investments in alternatives will be allowed to run off avoiding early termination costs.

Risks to realising benefits

Issue	Resolution
Criticisms of proposed changes – stakeholder concerns	
<ul style="list-style-type: none"> Savings could be achieved without setting up CIVs. A feeling that any of options 1/2/3 are taking a sledgehammer to crack a nut. 	
<ul style="list-style-type: none"> A belief held by well-run funds and funds with good performance that the real problem to be addressed is poorly performing funds and good funds should be left alone 	<ul style="list-style-type: none"> If there is no compulsion, funds with good performance can opt out
<ul style="list-style-type: none"> A perception or belief that option 3 will result in merging deficits and cross-subsidies between well-funded and poorly funded funds and employers. 	<ul style="list-style-type: none"> Easily avoided. Actuaries can continue to track individual employer/fund costs
<ul style="list-style-type: none"> It is too difficult 	<ul style="list-style-type: none"> Switch to passive for listed assets is relatively straightforward
<ul style="list-style-type: none"> Savings will be too small 	<ul style="list-style-type: none"> Report shows expected savings
<ul style="list-style-type: none"> Significant shift to passive has impact on active managers 	
<ul style="list-style-type: none"> Significant shift to passive – scepticism about passive and belief that active management benefits are worth the extra cost 	<ul style="list-style-type: none"> Research indicates lack of certainty of returns from active management
<ul style="list-style-type: none"> Change in asset allocation will disturb markets (and investee companies) 	<ul style="list-style-type: none"> No asset allocation shift planned
<ul style="list-style-type: none"> Decision making will become more concentrated, thereby increasing risk 	<ul style="list-style-type: none"> Asset allocation decision making left with funds in options 1 and 2
<ul style="list-style-type: none"> Investment entities will become too large, creating capacity limits which will inhibit investment choice 	<ul style="list-style-type: none"> Move to passive essentially removes capacity constraints on listed assets. Scale will improve efficiency on alternative assets
<ul style="list-style-type: none"> New entities may be inadequately resourced? 	<ul style="list-style-type: none"> Require adequate resourcing as a condition
<ul style="list-style-type: none"> Will the new structure be future proof? 	<ul style="list-style-type: none"> Address in the plan

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Details to be addressed

Issue
Who will bear the cost of change?
Entities running collective vehicles and merged funds
<ul style="list-style-type: none"> Who will run the collective vehicles and merged funds? What procurement process is required for their selection as operators? How and by whom will collective vehicles and merged funds be governed and held accountable? What level of resource do new entities require? Existing administering authorities have tax-raising powers which, in extremis, might be used to finance pension obligations not met by participating employers. Under option 3, would the entities running merged funds have precepting powers or ability to levy?
Collective vehicle investment choices
<ul style="list-style-type: none"> What investment choices would be available? Can new categories of asset be added? Will “hedging” categories (e.g. liability hedging) be included? What alternative asset options would be made available?
Actuarial aspects
<ul style="list-style-type: none"> Impact of cost savings on employer contributions

Future proofing

To what extent are the options future proof? The current project relates only to investment elements of structural reform. Can the result allow for:

- Future flexibility in funding and contribution management?
- Future flexibility in member and employer administration?

Option 3 has greater challenge in this area than options 1 and 2. The entity running a “merged fund” would need skills in investment, funding strategy (deficit management) and administration. These are essentially independent skill sets. The optimal future structure for administration, for example, may not be the same as that for investment pooling. Setting up an entity to manage all of three of these activities

- would be more complex;
- could add to establishment costs;
- could delay implementation and the emergence of cost savings.

6 Legal impediments to change and mitigation

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Issue	Resolution
<p>Powers to enact change</p> <p>Options 1 and 2</p> <p>Can funds be compelled to invest assets exclusively in collective investment vehicles which have been set up?</p>	<p>No power currently exists. Secondary legislation would be required to change the current investment powers of an administering authority</p>
<p>Option 3</p> <p>Status of “power” to merge funds (assets and liabilities)</p>	<p>Would need specialist counsel opinion to determine if primary legislation can be avoided and to rebut challenge.</p>
<p>Investment regulations</p> <p>Limits within existing legislation will inhibit the flexibility of pooled vehicles to provide the appropriate solutions</p>	<p>Re-draft the Investment Regulations (e.g. using a prudential risk framework)</p>

Executive Summary: Legal Issues

Options 1 and 2: Common Investment Vehicles: Issues and Interim Conclusions

1. The power of investment of an LGPS fund is vested in the administering authority, which also has a duty to invest monies it does not need to make payments from the fund. As such, since there is no power for another person, such as the Secretary of State, to exercise that function instead without regulatory intervention, administering authorities cannot be compelled to exercise their discretion to invest in a CIV (or any other instrument) without removing that function from them. On how such intervention might be made, however, see below generally under Option 3.
2. The Investment Regulations currently constrain LGPS funds’ investment powers by reference to some, but not all of the available structures and do so by reference to the legal form of the vehicle. Those Regulations expressly restrict investments in unit trusts, open-ended investment companies (OEIC) and life insurance unit linked funds when such vehicles are managed by the same body to impose maximum limits of 35% of fund assets at the time when an investment is made. Limited partnerships in aggregate (whether or not managed by the same body) are subject to an overall maximum limit of 30%, again measured at the time the investment is made.
3. Further limits apply by reference to other investments according to whether the investment is listed on a recognised stock exchange. Unlisted investments which are not caught by another limit under the Regulations are in aggregate limited to 15% of the fund, again at the time the investments are made.
4. The Regulations’ treatment of the financial services authorisation status of the expressly defined collective vehicles mentioned in 2 above is not the same. In order for an OEIC to benefit from the 35% limit, it must be a UCITS fund. This has implications for the investment powers of an OEIC, when compared to the alternative named vehicles, when used by an LGPS fund, as it would be constrained by the UCITS prudential rules in a way which need not apply to an unauthorised unit trust or limited partnership. A unit linked life fund is subject to separate prudential rules on the “permitted links” that the fund may hold, so again there are constraints as to what that vehicle may invest in.

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5. While the unit trusts and limited partnership models have therefore an advantage in terms of investment freedom, they would, as with any other non-UCITS and non-life insurance funds, be subject to the Alternative Investment Fund Managers Directive, which imposes prudential rules on both the managers of such vehicles (and third parties involved in their operation) and the vehicle itself. Each model will have significant financial services implications in its establishment and operation.
6. The Regulations are silent on other legal forms of collective investment which are recognised under foreign jurisdictions. These include established overseas vehicles, which operate on a tax transparent basis, such as the Irish common contractual fund and the Luxembourg equivalent, fonds commun de placement. (Other Luxembourg law collective vehicles could be used.) The Regulations may limit investments in these other vehicles if they are incapable of being otherwise characterised as unit trusts, OEICs or limited partnerships, either to the unlisted securities limit of 15% and/or to a single holding limit of 10%.
7. The new UK equivalent to these Irish and Luxembourg tax transparent entities, the authorised contractual scheme (ACS) may be established on either a limited partnership or a tenants in common co-ownership basis. The ACS is not mentioned in the Investment Regulations, so the same consideration of how the limits apply to an ACS on the tenants in common model as in 6 above would apply; the alternative limited partnership structure is of course covered by the Investment Regulations.
8. Different regulatory capital and tax treatments apply to each of the above vehicles, so the cost of operation and the investment efficiency of each from an LGPS fund's perspective will differ according to which model is used. Similarly, there are recognised means of segregating liability under sub-funds for some but not all models.

Collective Investment Vehicles: Key Differentiators

	Unauthorised UT	OEIC (UCITS)	LP	ACS	Life Fund
Direct Ownership of Assets by investors	no	no	yes	yes	no
Capital Requirements for operator	AIFM	UCITS	AIFM	AIFM	Life Directives (solvency II soon)
Restrictions on Investments	QIS limits (mainly real estate)	UCITS limits	QIS limits (mainly real estate)	QIS limits (mainly real estate)	Permitted links restrictions
Tax Transparent	no	no, but favourable tax regime	yes	yes	no but favourable tax regime
Enhanced Insolvency Protection	no	no	no	no	policyholders ahead of unsecured creditors
Segregation of Sub-Funds	no	yes	no	yes	no

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Conclusions

The anomalies created between the different collective investment vehicles could be addressed under secondary legislation by removing the current limits and adopting a prudential framework as used in the private sector. This would need to be accompanied by governance changes to ensure that the new flexibility created by reform of the Investment Regulations was not abused.

Option 3: Merged funds

Issues

9. A full merger of LGPS funds into however many new funds are deemed appropriate can only be achieved by confirming that the assets and liabilities of existing administering authorities can be transferred from their current control to other authorities or to new statutory bodies. In turn this leads to the following question: does the Secretary of State have the necessary powers to compel mergers of assets and liabilities? If not, primary legislation will be necessary to create such powers.
10. It is also necessary to look at other powers than those which govern the transfer of assets and liabilities. These include the degree of statutory prescription of functions which applies to current administering authorities and how scheme employers are mandated to adhere to a particular LGPS Funds.
11. The final consequential issue is whether third parties, whose rights and obligations are not expressly covered under the statutory framework, can also have their obligations and rights novated or assigned to apply to a new structure without individual contractual amendments.

Interim conclusions

12. The Secretary of State does possess broad powers to make regulations under both the Superannuation Act 1972 (1972 Act) and the Public Service Pensions Act 2013 (2013 Act) in relation to the LGPS. The architecture of the legislation is complex. The LGPS is one scheme (in the sense of a tax approved entity as opposed to different benefit structures created over time) and, although governed by different legislation, administering authorities' funds are not hypothecated by reference to pre and post 2014 benefit structures. Where statutory powers differ under primary legislation, care must be taken about interpreting how they may be exercised to the scheme as a whole and to administering authorities' funds individually.
13. Our analysis of these powers confirms that while they are very similar in wording and effect in nearly all cases, particularly in relation to the way that administering authorities are mandated to have responsibility for their own funds and how scheme employers are attached to such funds, the wording used in relation to the power to "amalgamate" (ie merge) funds is different. Under the 1972 Act, there is an express power to amalgamate, but under the 2013 no such express power exists. It should be noted that the relevant powers relate to "funds", which are not defined in either piece of primary legislation, but we take the term generally to refer to assets, not liabilities.
14. Although the 1972 Act power to amalgamate funds has not been revoked, it may be inadvisable to rely on that power alone to merge funds (or liabilities) given that it has no reference to post April 2014 benefits.
15. For these reasons and given the risk of challenge without a clear statutory power on this issue, we recommend that an opinion is sought from leading Counsel as to the scope of the 2013 Act powers.
16. The 2013 Act does contain regulation making powers by which the Secretary of State may change the person who is responsible for providing benefits under the LGPS (ie the administering authority).

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17. In relation to the final question under paragraph 11 above, there is no express power to novate or assign contracts between administering authorities and third parties (whether admission agreements or supply contracts for services). The 2013 Act does contain a power for the passing of consequential, supplementary, incidental or transitional provisions by regulations. Thus, if it can be established that an appropriate power does exist in the 2013 Act to merge assets and liabilities, it may be that that power could be used to effect such reorganisation of contractual arrangements.
18. There are some recent precedents for reorganisation of LGPS assets and liabilities, relating to the abolition of the GLC and metropolitan councils under the Local Government Act 1985 ie under primary legislation.

Non-LGPS funds: application of Options

19. Since each of the schemes under consideration is governed by a separate trust deed and rules and not statute, like the LGPS, the investment and merger powers of those schemes are bespoke to each arrangement. Without further investigation as to the relevant trust powers, all that can be concluded is that there is no power to compel the trustees of these schemes either collectively or singly to invest in a CIV or to merge, either with each other or under a newly established scheme which might be established for LGPS funds.

7 Stage 2 funds

Background

Private sector – governance framework

In the private sector, the Trustee of an occupational pension scheme is a legally separate entity from that of its sponsoring employer or indeed any of the participating employers. The Trustee is the legal owner of the underlying assets but looks after those assets on behalf of the beneficiaries. The ability to pay beneficiaries' benefits, defined in a Trust Deed and Rules, depends on the resources of the scheme which are made up of the assets, the investment return on the assets and future contributions from the employer(s) and, if applicable, the members of the scheme. The employer's ability to continue making the contributions, i.e. its covenant, is therefore central to the security of the beneficiaries' benefits. The Trustee has a duty to collect the contributions, to invest the assets and contributions prudently and to help ensure that the correct benefits are paid to the right people at the right times. The trustee is therefore pivotal to the security of the benefits. Partly because of this, trustees are subject to much trust law (both pension and non-pension) and are heavily regulated. As a fall back, there is the Pension Protection Fund (PPF). However, the benefits payable from the PPF are typically lower than would be paid from the scheme.

Trustees in place for some time tend to build up a fairly strong pool of knowledge and skills. To help them, they appoint advisers. Trustees are required by law to appoint a scheme actuary, an auditor and investment manager(s). The funding must normally be agreed with the employer and the trustee has to consult with the employer on investment strategy. Ultimately, however, it is the trustees rather than the employer who have the final say.

Public sector – governance framework

In the LGPS, the administering authority for a fund (which is usually also the main employer) is responsible and liable for the benefit payments. The benefits themselves are guaranteed under statute; that is the payment of benefits does not depend on the state of the assets of the scheme nor the contributions paid into it by the employer. As a consequence, the interest of the members in the LGPS lies largely in the arena of service delivery and communication, rather than security of assets. The administering authority may, and usually does, delegate pension activities under s101 of the Local Government Act 1972 to officers and committee(s). Best practice guidance mandates the formation of a pensions committee, called the section 101 committee. Unlike the Trustee situation, the section 101 committee is not legally separate from the administering authority. The running of an LGPS Fund is arguably therefore a "buffer fund" which assists in budgeting and contribution smoothing because of its impact on the administering authority's finances. Although never tested in the courts, there is widespread belief that, as a fall back, the Government would be the ultimate guarantor for the benefits. To date, LGPS Funds have not been as heavily regulated as their private sector counterparts but this is gradually changing as strengthened governance of LGPS Funds is sought. Funds have to appoint an actuary and an auditor but the reporting mechanism and nature of the actuarial advice differs from private sector scheme arrangements. The officers are very much the 'executive' arm of any committee(s) but invariably decisions are made by committee following officer recommendations. The high turnover among members of committees makes it difficult for the knowledge and skill level to build up. Whilst an actuary and an auditor have to be appointed, funding and investment are ultimately the responsibility of the administering authority.

Changes expected to be made through current governance reforms are likely to reduce some of the differences between the running of a private sector fund and its LGPS counterpart.

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Other funded public sector schemes

The spreadsheet of schemes identified by DCLG as falling to be considered in Stage 2 is included as Appendix 6A. We have traced information on 23 out of the 65 funds listed. A summary of our findings of the broad asset allocations for these funds is included in Table 19 below.

Table 19: Asset allocation of some other funded public sector schemes

Pension Fund	Equities %	Bonds %	Property %	Alternatives %	Value (£m)
BR (Railways Pension Scheme)	57	33	9	2	18,226
British Coal Staff Superannuation Scheme	68	17	7	7	9,105
Mineworkers Pension Scheme	66	19	10	5	10,960
The BT Pension Scheme	23	46	11	20	38,783
The Audit Commission Pension Scheme	0	14	0	86	662
Bank of England Pension Fund	0	100	0	0	3,122
The British Museum Company Ltd Ret Bens Plan	8	15	15	62	10
British Tourist Board Staff Pension Life Assurance Scheme	41	27	9	23	197
British Transport Police Railway Pension Scheme	53	17	9	21	76
British Waterways Pension Fund	57	43	0	0	308
Combined Nuclear Pension Plan (all sections)	40	35	10	15	678
Combined Nuclear Pension Plan (Closed section)	70	30	0	0	72
GPS Pension scheme (at 31/3/2012 before transferring to CNPP) in WEC/UAM/SLC	38	34	9	19	539
Nirex Pension Scheme (part of CNPP)	50	50	0	0	26
Environment Agency Active Fund	78	19	3	0	2,122
Environment Agency Closed Pension Fund	0	100	0	0	167
Financial Services Authority	48	45	6	0	484
Highlands and Islands Airports	58	42	0	0	71
Highlands and Islands Enterprise	61	39	0	0	64
Legal Services Commission No.4 Pension Scheme	45	52	0	3	352
OFCOM Staff Pension Scheme	16	22	0	62	249
PCPF	69	21	10	0	493
Student Loans	40	30	10	20	57
WEIGHTED AVERAGE/TOTAL	41	38	9	12	86,824

Feasibility of applying changes to these schemes

Since each of the schemes under consideration is governed by a separate trust deed and rules and not statute, like the LGPS, the investment and merger powers of those schemes are bespoke to each arrangement. Without further investigation as to the relevant trust powers, all that can be concluded is that there is no power to compel the trustees of the schemes either collectively or singly to invest in a CIV or to merge, either with each other or under a newly established scheme which might be established for LGPS funds.

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Other	Northern Trust, HM Treasury All contributors to the Call for Evidence

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Appendix 1a Investment cost benchmarking CEM Benchmarking Inc.

The CEM approach

The CEM investment benchmarking survey and methodology has been developed over 21 years in conjunction with leading global pension funds. CEM captures the entire cost of investing the assets⁶, including internal costs, investment manager fees and the cost of oversight and governance. Note that pension administration costs are specifically excluded from the analysis.

CEM takes great care to capture data consistently and accurately:

- They discuss the data collection process with all potential participants before starting
- They have a standard on-line survey that includes guidance on categorising data and that immediately identifies unusual or outlying data
- They discuss data issues with funds at length

They use defaults (typically peer or universe averages) where a fund cannot provide robust data.

The main drivers of pension investment costs are:

- Economies of scale (funds with more assets have a scale advantage)
- Asset mix (e.g. private equity is much more expensive than public equity)
- Implementation style (e.g. active is more expensive than passive management)
- What funds pay relative to peer funds for similar assets and activities

CEM's Cost Benchmarking Methodology – gathering, collating and analysing the LGPS data

Detailed data was gathered from 18 LGPS funds (who volunteered their data) with combined assets of c£38bn. This Combined LGPS Fund Small is treated as a proxy for one of the five asset pools / merged funds under DCLG options 2 and 3. The combined costs for these funds were compared with a global peer group of 21 funds in the range £25bn to £45bn (median £35bn size, LGPS 6th in size). CEM calculated a Benchmark Cost for Combined LGPS Fund Small. The Benchmark Cost applies the median cost for each asset class from the peer comparators to the Combined LGPS Fund's actual asset mix. The effect is to neutralise the impact of asset mix differentials in the cost comparison. By comparing Combined LGPS Fund's costs with the Benchmark Cost it is possible to understand whether Combined LGPS Fund's costs are reasonable and to analyse why they compare the way they do.

As a proxy for a single asset pool, as included in DCLG option 1, the cost data for the 18 sample LGPS funds was used again but CEM superimposed the current actual asset mix for the whole of the LGPS to assets of £180bn. CEM recalculated a Benchmark Cost for this larger fund, Combine LGPS Fund Large in the same way. The 16 global peers for this comparison have assets in the range £67bn to £408bn (peer median size £101bn, LGPS 4th largest).

⁶ All investment costs are included with two exceptions: transaction costs (related to buying/selling securities) and performance fees for private market asset classes (e.g. Private Equity, Real estate, Hedge Funds, Infrastructure). These costs are excluded because of historical difficulties in obtaining comparable data from participating funds.

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Cost results**Combined LGPS Fund Small**

Combined LGPS Fund Small's total investment costs were 57.5 bps (0.575% of total assets). This comprised direct investment management costs of 55.0 bps and oversight, custodial and other costs of 2.5bps.

The Benchmark Cost was 54.6 bps – so Combined LGPS Fund Large was 2.8 bps more expensive than the benchmark.

Table 20: Explaining why Combined LGPS Fund Small's costs are 2.8bps higher than Benchmark Cost

	Excess Cost/(Savings) £000s	Excess cost/(Savings) bps
Higher cost implementation style		
• Greater use of fund-of-funds	7,751	2.1
• Differences in the use of active management	(13,664)	(3.6)
• Higher use of external management	22,177	5.9
• Higher use of overlays	<u>513</u>	<u>0.1</u>
	16,778	4.5
Paying more than peers for similar assets/activities		
• External investment management costs	(7,120)	(1.9)
• Internal investment management costs	(217)	(0.1)
• Oversight, custodial and other costs	<u>1,229</u>	<u>0.3</u>
	(6,107)	(1.6)
Total	10,670	2.8

The 18 LGPS funds have higher costs because

- They use more fund of funds than the peer group
- They have less internal management and therefore use more external management than the peer group.

These higher costs are offset to some extent because the LGPS funds

- Have more assets managed passively than the peer group does
- Pay less than the peer group for external management.

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Combined LGPS Fund Large

Combined LGPS Fund Large's total investment costs were 44.0 bps (0.46% of total assets). This comprised direct investment management costs of 41.5 bps and oversight, custodial and other costs of 2.5bps.

The Benchmark Cost was 40.6 bps – so Combined LGPS Fund Large was 3.4 bps more expensive than the benchmark.

Table 21: Explanation of why Combined LGPS Fund Large's costs are 3.4bps higher than Benchmark Cost

	Excess Cost/(Savings) £000s	Excess cost/(Savings) bps
Higher cost implementation style		
• Greater use of fund-of-funds	7,030	0.4
• Differences in the use of active management	9,840	0.5
• Higher use of external management	57,422	3.2
• Lower use of overlays	<u>(16,060)</u>	<u>(0.9)</u>
	58,233	3.2
Paying more than peers for similar assets/activities		
• External investment management costs	(18,210)	(1.0)
• Internal investment management costs	183	0.0
• Oversight, custodial and other costs	<u>21,731</u>	<u>1.2</u>
	3,705	0.2
Total	61,937	3.4

When the Combined LGPS Fund Large is compared to the larger peer group most of the same characteristics are observed as for the Small Fund. The notable difference is in the use of passive management. The LGPS fund uses less passive management than the peer group; larger funds have a higher allocation to passive management than the smaller funds. Some global research suggests that this is because of the diseconomies of scale that the largest funds experience and which increase the risk of moving prices against themselves when transacting in quoted equities.

Appendix 1b Detailed analysis of active to passive savings

Asset Class	Holdings (£millions)	Actively managed (£millions)	Passively managed (£millions)	Current Fees (£000)	Passive fees (£000)	Savings
Equities						
Asia Pacific	13,343	7,032	6,311	31,196	13,210	17,986
UK	49,406	24,162	25,244	101,538	19,268	82,270
Europe ex UK	15,146	7,934	7,213	20,413	20,296	117
US	17,490	8,475	9,016	28,814	10,319	18,495
Emerging Markets	8,835	6,131	2,705	56,391	19,790	36,601
Global	13,704	12,802	902	49,716	12,334	37,382
Total equities	117,924	66,536	51,391	288,068	95,217	192,851
Bonds						
UK	17,130	8,655	8,475	24,144	14,218	9,926
Emerging Markets	708	708	0	5,722	1,770	3,952
Global	5,783	5,783	0	25,835	4,800	21,035
Index linked	7,934	2,524	5,409	5,370	2,301	3,069
Total Bonds	31,555	17,670	13,884	61,071	23,089	37,982
Property	12,146	12,146	0	97,996	97,996	-
Alternatives	17,528	17,406	122	301,151	300,883	268
Cash				603	603	-
Total	179,153	113,758	65,397	748,889	517,787	231,102

Appendix 1c Components of transaction costs

Explicit transaction costs

Some transaction costs are said to be explicit because they do not depend on the trade price and are usually documented separately from it. They include brokerage commissions, market fees, clearing and settlement costs, and taxes/stamp duties all of which are generally known in advance, before the execution of the trade.

Commissions

Brokerage commissions are paid to intermediaries for executing trades. Although they differ from one intermediary to another, they are a fixed and visible component of transaction cost.

Market fees

Market fees are paid to trading venues for executing trades on their platforms. They are usually bundled into brokerage commissions for investors. These fees vary; on average, higher volume markets have the lowest costs. In recent years, competitive pressure has led to a significant reduction in these explicit costs.

Clearing and settlement costs

Clearing and settlement costs are related to the process whereby the ownership of securities is transferred. When the trading venue owns the clearing and settlement system, these costs, which are fixed and visible transaction cost component, are usually included in market fees. Like the latter, clearing and settlement costs differ from one trading venue to another.

Taxes/stamp duties

Tax rates or specific stamp duties are known in advance ; for example purchases of UK equities attract stamp duty of 0.5% of the purchase price.

Implicit transaction costs

Transaction costs are more than just brokerage commissions, market fees and taxes. The cost of a transaction depends on its size, the timing of the trade and the way in which it is handled. The impact of these factors is implicit in the trade price and cannot be known in advance. These implicit costs can be broken down into their components: spread, market impact and opportunity costs.

Spread

The spread is the difference between the best offer price (i.e. the lowest price at which the securities can be bought) and the best bid price (i.e. the highest price at which the securities can be sold).

Market impact

Market impact is the difference between the actual execution price for a transaction and the price that would have prevailed if the security had not been traded; in other words the amount by which the transaction moved the price.

Opportunity costs

The decision to trade and the actual trade do not usually take place at the same time. Market prices can move for or against the proposed trade. The opportunity cost is the loss (or gain) incurred as a result of the delay in completion of a transaction following the decision to trade.

Appendix 1d Transition test methodology

Background

In order to consider cost of transition for the LGPS, we asked two transition managers to estimate cost of change. The managers are experienced in the transitioning of LGPS assets and are aware of the portfolio distributions of institutional managers of UK mandates. Part of the instructions provided to the transition managers was to err on the side of prudence, which in this case means aiming to avoid an underestimate of the cost.

The transition was limited to listed securities, i.e. UK and global equities, which accounts for over 80% of aggregate LGPS assets. It is not feasible to transition property or alternative assets, e.g. private equity or other assets in closed funds.

The transition model

The legacy portfolio

Listed assets comprise 83% of aggregate LGPS assets, and are currently managed as follows:

- Approximately 23.5% of these assets are currently managed passively
- Approximately 12.5% of assets are currently managed internally, i.e. the securities are held in dedicated portfolios managed by personnel in the administering authorities
- The balance (47% of assets) are currently managed by external active managers.

The target portfolios

We asked the transition managers to consider the following transition scenario:

- The existing passively managed assets and internally managed assets would remain in place.
- All externally managed assets (c£84bn) would transition to passive management.

Asset allocation

We used the data as at 30 September 2013 from The WM Company as the basis for the asset allocation of "legacy" assets. In relation to the shape of the target portfolio we made the following assumptions:

- The shape of the allocation to equities (i.e. the proportions held in the UK and regional overseas equity markets remained unaltered.
- In relation to bonds, WM data showed a modest allocation to overseas index-linked bonds which we transferred to UK index-linked gilts and a modest allocation to pooled bonds which we transferred to UK fixed interest (a composite of gilts and corporate bonds).

Transition approaches

The transition managers' approaches follow three stages:

- 1) Comparing the legacy and target portfolios, in order to determine overlap of securities (both by security name and the number held). These holdings will transfer in kind between the legacy and target portfolio and will bear no costs (other than custody costs of re-denomination)
- 2) Internal crosses within the transition management operation (e.g. with other clients). This includes dual listed shares, e.g. the legacy portfolio may hold US-listed depositary receipts which are essentially the US-listed clone of a security listed on another exchange.
- 3) Externally traded securities with execution normally conducted via programme trades and through brokered deals. Transition managers make extensive use of this type of dealing so broking commissions are set at

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the lowest commodity level. Trades are executed efficiently to minimise market impact, i.e. avoiding the size of dealing affecting the dealing price. Clearly exchange costs and duties are unavoidable.

Provisos

- The cost estimate assumes that implementation of the transition is carried out as a single co-ordinated exercise.
- The process and timescale for the transition is designed to minimise costs; the volume of trades involved will require multiple tranches of transitions to avoid high market impact costs.

Analysis of test transition

UK equities

UK equities form the largest equity category. The transition manager made assumptions about the shape of portfolios of active UK equity managers (based on their knowledge of managers' portfolios from transitions they conduct and our breakdown of the largest managers of UK equity mandates for the LGPS and the proportions of assets they manage).

The transition managers estimated that approximately 60% of assets would be retained (essentially a nil cost transfer) and 40% of assets would need to be sold (and replacement holdings bought). Cost of trading of UK equities was estimated at £9.5 million (sell side) and £56.8 million (buy side). The high cost of the buy side is due to unavoidable stamp duty of 0.5% of the value of buy trades.

Overseas equities

The transition manager made assumptions about the shape of portfolios of active global and overseas equity managers mandates (based on their knowledge of managers' portfolios from transitions they conduct and our breakdown of the largest managers of these mandates for the LGPS and the proportions of assets they manage).

The transition managers estimated that just over half (approximately 53%) of assets would be retained (essentially a nil cost transfer) and approximately 1% of the balance can be transferred between overseas and UK holding (dual listing). That leaves approximately 46% of overseas assets to be traded externally. Cost of trading of overseas equities was estimated at £42.7 million (sell side) and £42.0 million (buy side).

Bonds

The bond transition involved a movement of approximately £17.6 billion of assets from active to passive mandates. For securities within these mandates, 32% of assets will be retained in the target portfolio. This leaves a net transaction of approximately £12 billion of buys and sells. The transition managers estimated a cost of £45 million for executing these trades.

Summary

The estimate for transition costs from external to active management was as shown in table 22 opposite.

Based on aggregate LGPS assets of £180 billion, where the amount of listed assets is approximately £150 billion, the transition cost would result in a transition "slippage" amounting to just under 0.12% of LGPS assets.

Table 22: Analysis of transition costs

Asset category	Transition cost £m
UK equities	90
Overseas equities	87
Bonds	38
Total	215

Potential variation in transition cost

It will be necessary to conduct further, more detailed, investigations of transition arrangements before any transition is conducted. This will include obtaining greater detail on the constituents of the current actively managed portfolios. Planning of the transition is vital. This will include elements such as phasing of tranches and timing between tranches.

In our financial analysis in Chapter 3, we have shown the sensitivity of financial outcomes, dependent on more prudent (i.e. higher) assumed transition costs.

Comments

- The cost of transition may seem significant as an up-front cost but it is actually no more than the hidden additional turnover costs incurred in active management which will be saved by investing passively for just one year.
- No additional funding or up-front cash is required from government or from local authorities. Transition costs are met from the assets of the scheme and would be reflected in asset valuations (like other investment transaction and turnover costs).
- Even allowing for other implementation costs, the payback period (i.e. the period over which savings from the transfer from active to passive management will exceed the cost of transition) is likely to be just over **one year**.

Appendix 2a Performance analysis

All of the Fund performance data used in this Appendix is based on aggregate WM Local Authority data from State Street Investment Analytics (The WM Company).

Performance and correlation

Overview

A summary of asset class performance is shown in tables 1 and 2. All performance is shown gross of managers' fees, but does reflect the cost of transactions and turnover. We provide additional information on each region and asset class in the following sections. General points to note include:

- In table 23, we have provided one, three, five and ten year performance to 31 March 2013. These represent a snapshot over time. There is overlap between these four time periods, e.g. the one year performance to 31 March 2013 is included in the all four figures quoted; the three year figures form part of the five year and ten year data.
- In table 24 we have provided performance for the four years to 31 March 2007, the two years to 31 March 2009 and the four years to 31 March 2013. This allows the analysis to show how Funds and markets performed going into, during and coming out of the financial crisis.
- Funds use a range of underlying benchmark indices. The indices shown in tables 1 and 2 provide an indication of relative performance; but will not necessarily reflect the benchmarks used by the underlying Funds; this is most notable for Global, Asia Pacific and Emerging Markets mandates, where a large number of benchmark indices exist.
- Each benchmark index operates with specific rules, e.g. treatment of taxes, timing of additions and exits from the index, approach to reinvesting dividends etc. Depending upon the specific rules, the index rules may not be practically replicated so would act as a headwind or they may create an opportunity to add value above the benchmark return (even if invested on a passive basis). As an example, UK pension funds can reclaim tax paid on dividends in some areas of the Pacific, whereas the index assumes that only dividends net of tax are reinvested. Typically, passive funds in the Pacific area can outperform the index by 0.2% p.a. purely on the basis of the tax reclaimable.
- The Funds' performance includes a combination of active and passive performance. It is reasonable to expect that asset classes with large allocations to active management would deviate further from benchmarks (in technical terms, have higher "tracking errors") than asset classes with large passive allocations.
- WM's data groups the Fund's conventional gilts and corporate bond holdings together, rather than separating them. In tables 1 and 2, we have shown the Funds' performance relative to both gilts and investment grade corporate bonds, reflecting the two main asset classes that are classified as "conventional" bonds.
- Funds may adjust their asset allocation from time to time. Depending on timing, this could have a positive or negative impact. To give an example, it would be possible for a Fund to outperform in every asset category but underperform its aggregate Fund index if its asset allocation positioning damaged returns to a significant extent (i.e. by being overweight in underperforming asset classes). The converse can also apply.

Table 23: Summary performance (performance shown gross of fees to 31 March 2013)

	One year %	Three years %p.a.	Five years %p.a.	Ten years %p.a.
UK equities	18.0	9.8	7.3	10.8
FTSE All Share	16.8	8.8	6.7	10.7
<i>Relative</i>	+1.1	+0.9	+0.6	+0.1
North American equities	19.0	11.4	10.5	8.4
FTSE North America	19.3	11.8	11.5	9.5
<i>Relative</i>	-0.2	-0.4	-0.9	-0.9
Europe ex UK	20.4	5.9	4.1	11.6
FTSE Europe ex UK	17.8	4.0	2.9	11.4
<i>Relative</i>	+2.2	+1.8	+1.2	+0.2
Japan	15.4	5.3	5.9	7.5
FTSE Japan	14.3	3.5	5.1	7.4
<i>Relative</i>	+1.0	+1.8	+0.8	+0.1
Asia Pacific ex Japan	19.2	9.3	11.4	17.3
FTSE Pacific ex Japan	18.1	8.9	10.7	16.4
<i>Relative</i>	+0.9	+0.4	+0.6	+0.8
Emerging Markets	10.5	4.3	6.8	17.1
FTSE Emerging	7.4	3.2	7.2	18.2
<i>Relative</i>	+2.9	+1.1	-0.3	-0.9
Conventional bonds	10.6	8.8	8.6	6.2
FTSE All Stocks	5.2	8.2	7.1	5.8
<i>Relative</i>	+5.0	+0.6	+1.4	+0.4
Conventional bonds	10.6	8.8	8.6	6.2
iBoxx Corp All Stocks	13.2	8.8	7.9	5.7
<i>Relative</i>	-2.3	0.0	+0.6	+0.5
Index-linked gilts	11.2	12.3	9.3	8.0
FTSE IL>5yr	11.8	13.0	9.1	8.3
<i>Relative</i>	-0.5	-0.6	+0.1	-0.2

Table 24: Additional performance (performance shown gross of fees to 31 March 2013)

	4 years to 31/03/07 % p.a.	2 years to 31/03/09 % p.a.	4 years to 31/03/13 % p.a.
UK equities	21.1	-19.6	19.1
FTSE All Share	21.1	-19.3	18.3
<i>Relative</i>	<i>-0.1</i>	<i>-0.5</i>	<i>+0.6</i>
North American equities	10.0	-11.8	18.5
FTSE North America	10.8	-9.5	18.9
<i>Relative</i>	<i>-0.8</i>	<i>-2.5</i>	<i>-0.3</i>
Europe ex UK	24.7	-15.9	15.0
FTSE Europe ex UK	25.5	-15.6	13.6
<i>Relative</i>	<i>-0.6</i>	<i>-0.3</i>	<i>+1.2</i>
Japan	16.6	-15.2	11.6
FTSE Japan	17.0	-13.0	9.5
<i>Relative</i>	<i>-0.3</i>	<i>-2.4</i>	<i>+1.9</i>
Asia Pacific ex Japan	26.7	-6.0	21.2
FTSE Pacific ex Japan	25.3	-7.5	21.2
<i>Relative</i>	<i>+1.2</i>	<i>+1.7</i>	<i>-0.1</i>
Emerging Markets	31.6	-8.0	17.5
FTSE Emerging	32.9	-5.7	17.7
<i>Relative</i>	<i>-1.0</i>	<i>-2.4</i>	<i>-0.1</i>
Conventional bonds	4.0	1.9	10.7
iBoxx £ Overall	4.4	2.6	8.6
<i>Relative</i>	<i>-0.4</i>	<i>-0.7</i>	<i>2.0</i>
Index-linked gilts	5.6	4.9	12.2
FTSE IL>5yr	6.0	5.0	12.4
<i>Relative</i>	<i>-0.3</i>	<i>-0.1</i>	<i>-0.2</i>

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Asset class and regional performance comments

Annual performance (12months ending 31 March of each year) and cumulative performance information are included later in this appendix (performance is shown for each asset class, relative to the underlying index over the past ten years). Points to note include:

- The Funds' information is based on aggregate performance. It does not show the level of dispersion between underlying Funds' and their managers' performance.
- Asset class performance has exhibited considerable volatility of recent years. This is reflected both in the absolute returns that have been generated, and in the relative returns.
- At a regional level, Funds' relative equity performance was poor during the build up to the credit crisis (2003-2007), with underperformance in UK, North America, Europe ex UK, Japan and emerging markets, and outperformance only being achieved in Asia Pacific. Part of this outperformance arises because funds can reclaim tax paid on dividends in some countries, whereas the benchmark assumes net dividends.
- Funds also struggled in the volatile markets witnessed during the credit crisis (i.e. 12month periods to 31 March 2008 and 31 March 2009). North America, Japan and emerging markets equities underperformed benchmark returns in both of these years and the UK and Europe underperformed in at least one of these years and over the two year period in aggregate.
- Over recent years there are signs of improved performance. Over the most recent 12 months, the analysis suggests there has been outperformance in the UK, Europe ex UK, Japan, Asia Pacific and Emerging markets. North American has continued to prove to be a difficult market for Funds to add value above the index.
- As a whole, Funds' index-linked gilts portfolios have struggled relative to the market return, underperforming in seven out of the past ten years and only outperforming in two years. There has also been underperformance in each of the three time periods shown in table 24 - reflecting the performance pre, during and post the financial crisis.
- Given the nature of WM's data, it is difficult to draw too many conclusions relating to Funds' conventional bonds. The WM data does not outline the precise mix of the underlying holdings are (they will be largely gilts and corporate bonds) or the proportions of assets that each category represents or the nature of these holdings e.g. duration, credit criteria, etc.

Relative to the composite index (iBoxx £ Overall) that we have used in this appendix, Funds have tended to be overweight corporate bonds and underweight gilts; further, within corporate bonds, they have tended to be overweight in lower graded issues compared with the benchmark. This disposition explains benchmark outperformance in the last 4 years.

We are also aware that Funds' corporate bond performance was very volatile during the credit crisis and the dispersion of returns achieved by Funds over that period was particularly wide.

Correlation analysis

The following three year Fund and index return correlations are shown below:

- Total equities (chart 2)
- Regional equities (chart 3)
- Bonds (chart 4).

Chart 2: Total equities

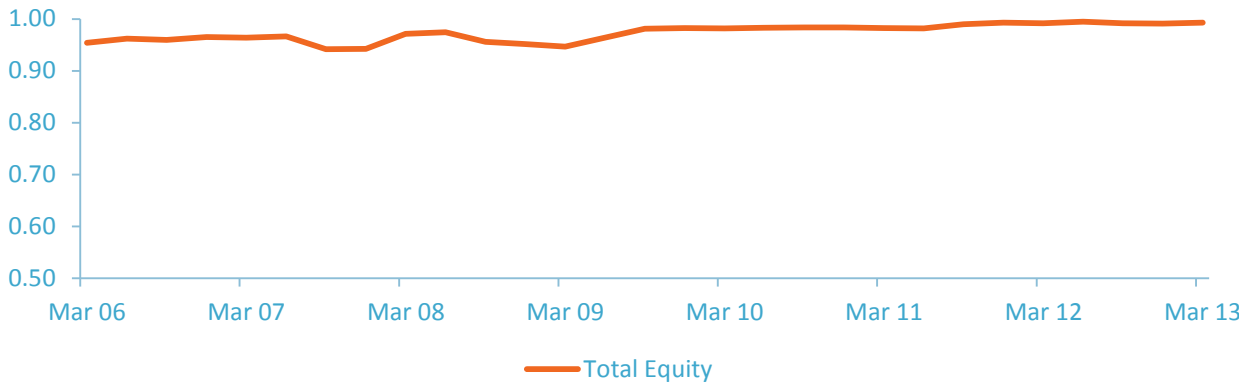
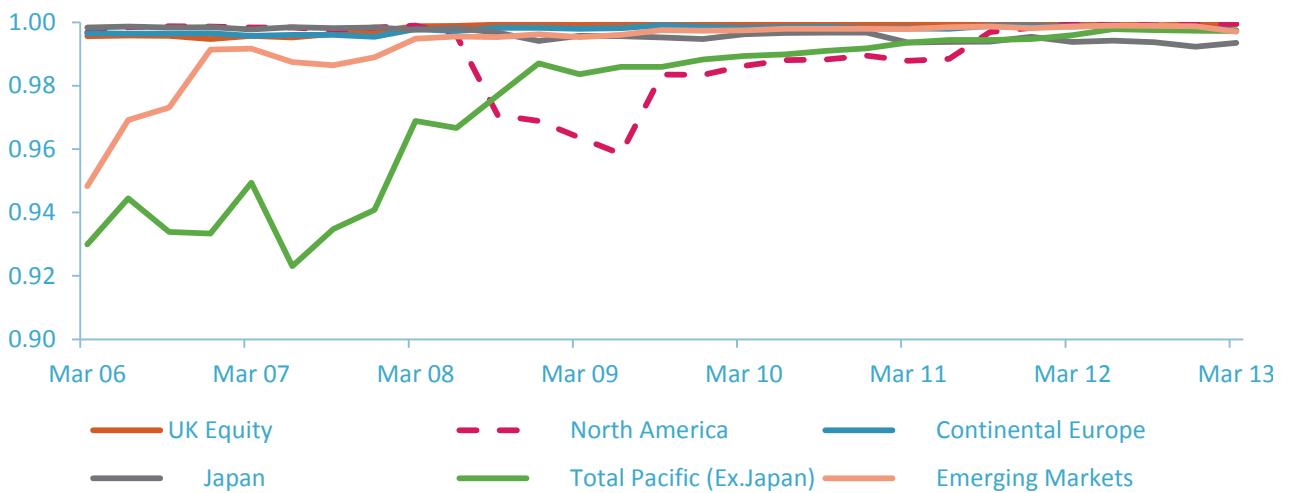
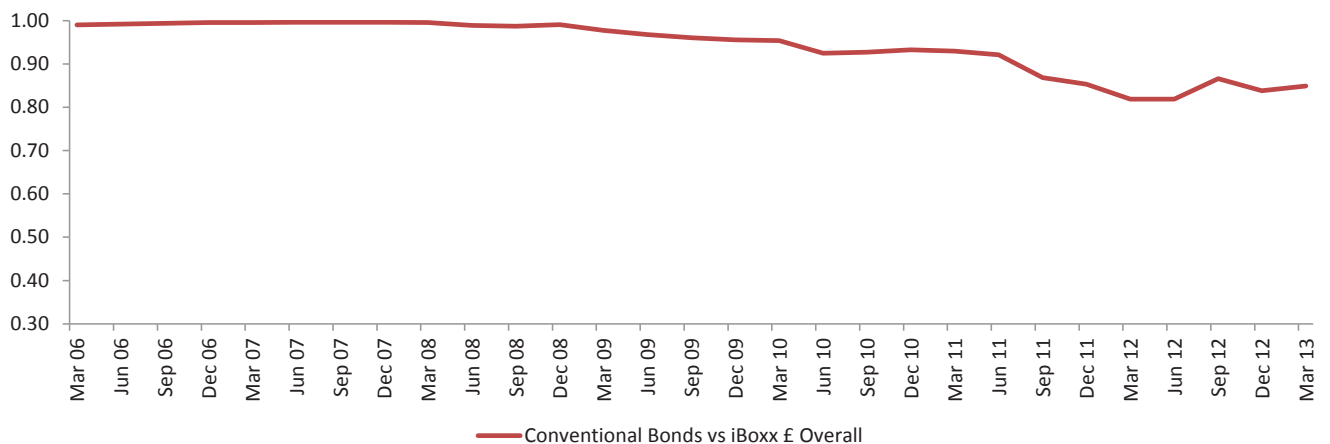


Chart 3: Overseas equities



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Chart 4: Conventional bonds and iBoxx £ Overall

- Correlation data provides an indication of strength of the relationship between the Funds' returns and underlying index returns. It does not provide any information of the scale of the relative moves. For example, even the returns of a highly active equity manager are likely to be highly correlated with the broad market index, e.g. in excess of 0.8. Given this, we believe there are only limited conclusions that can be drawn from looking at the correlation data in isolation.
- The correlation of the Funds' aggregate equity returns, with the broad market index, tends to be very high (in excess of 0.9). This should be expected because:
 - There will be considerable overlap between the Funds' and index holdings, in particular the larger stocks that tend to be key drivers of risk and returns.
 - Regional equity markets tend to be highly correlated over time; therefore any regional differences between the Funds and the broad benchmark index should have limited impact on any correlation analysis.
- The correlation of the Funds' regional returns with the broad market indices also tends to be high. This is particularly notable for North American, Japanese, UK and European equities. This is again largely due to the high level of overlap between the Funds' and index holdings.
- Asia Pacific and emerging markets correlations tend to be lower than other regional markets. This is due largely to the more diverse nature of these mandates i.e. Funds use a number of different Asia Pacific and emerging markets benchmarks, each of which include different countries and stocks. These benchmark differences can have significant impacts on returns. Nevertheless, whilst the correlations are lower than other regions, they remain high, in excess of 0.9.
- Over recent years there has been a notable increase in correlations between regional markets and their underlying indices, suggesting that key drivers of the performances of Funds and indices are now more closely aligned.

In chart 4 we show the correlation of Funds' conventional bond returns, relative to an aggregate index (iBoxx £ Overall) of gilts and UK investment grade corporate bonds. As shown, the correlation has reduced following the Global Financial Crises as managers have moved underweight in gilts relative to the benchmark index and correspondingly overweight in corporate bonds, and more lowly-rated investment grade corporate bonds relative to the benchmark index.

Performance figures (12 months to 31 March, and 3, 5 and 10 years to 31 March 2013)

Chart 5: UK equities

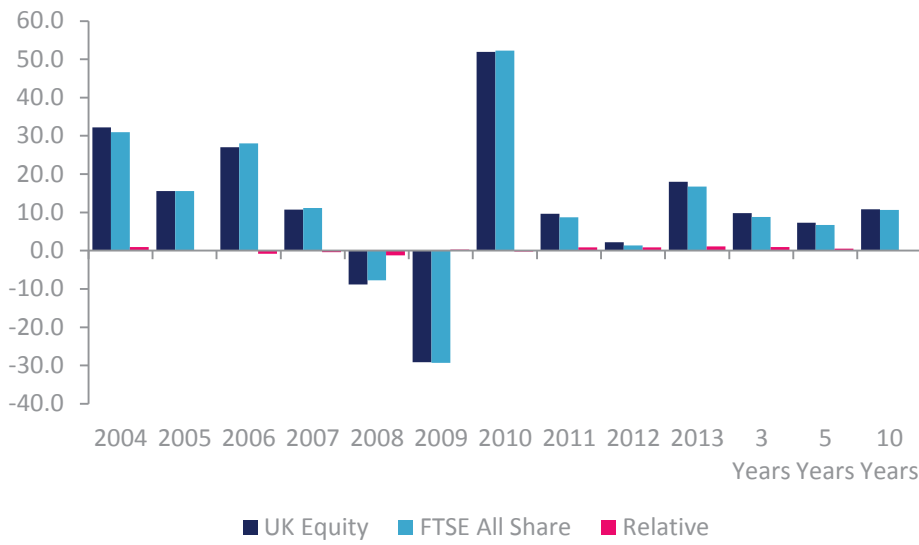
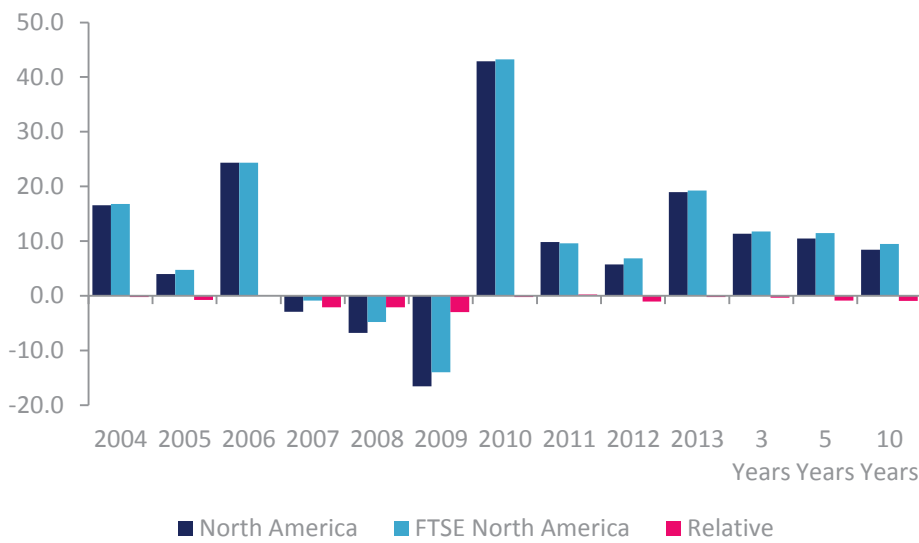


Chart 6: North American equities



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Chart 7: Europe ex UK equities

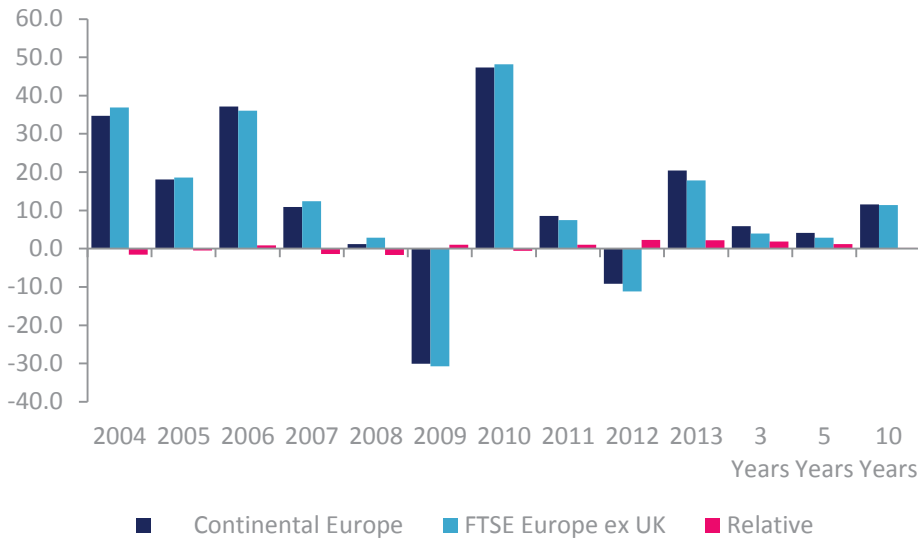
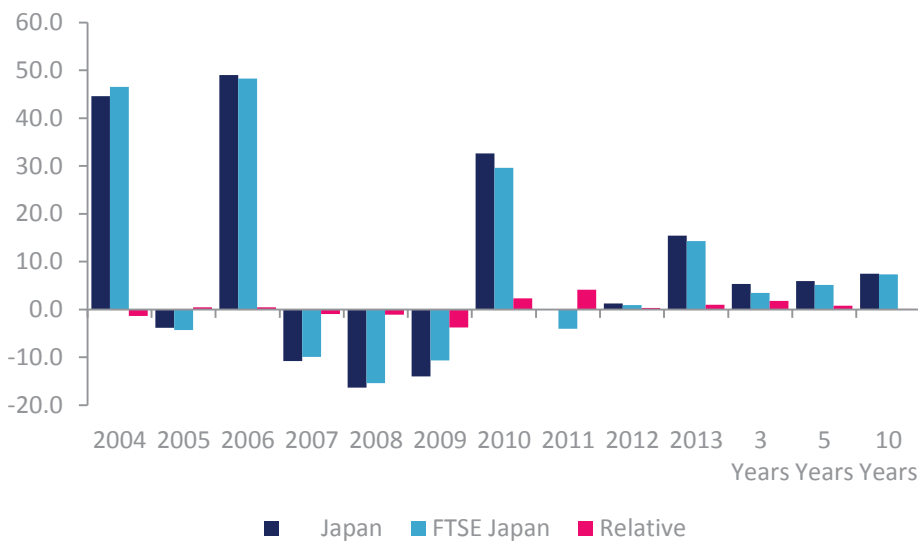


Chart 8: Japanese equities



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Chart 9: Asia Pacific equities

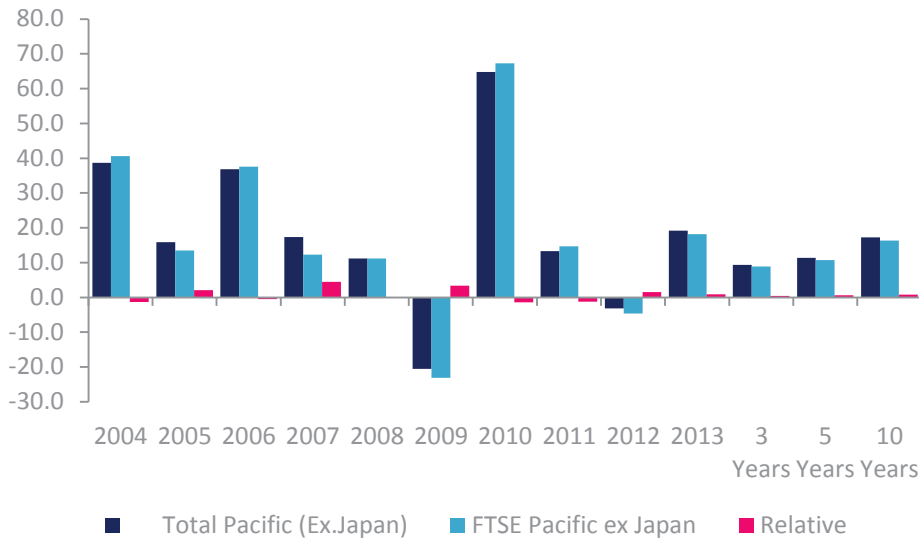
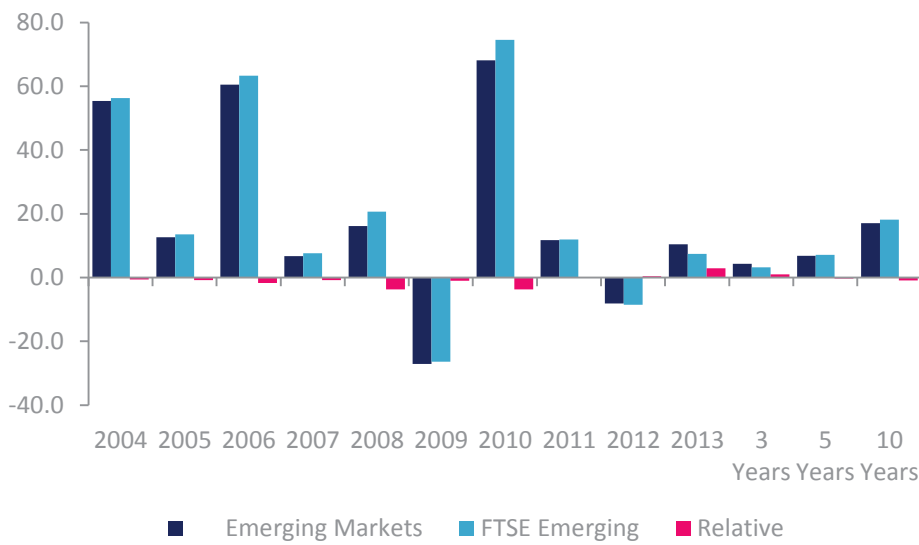


Chart 10: Emerging markets equities



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Chart 11: Conventional bonds versus composite UK bonds (iBoxx £ Overall)

Since mid-2009, funds have typically held less in gilts and more in corporate bonds than the benchmark index and have typically held lower grades of corporate bonds than the index

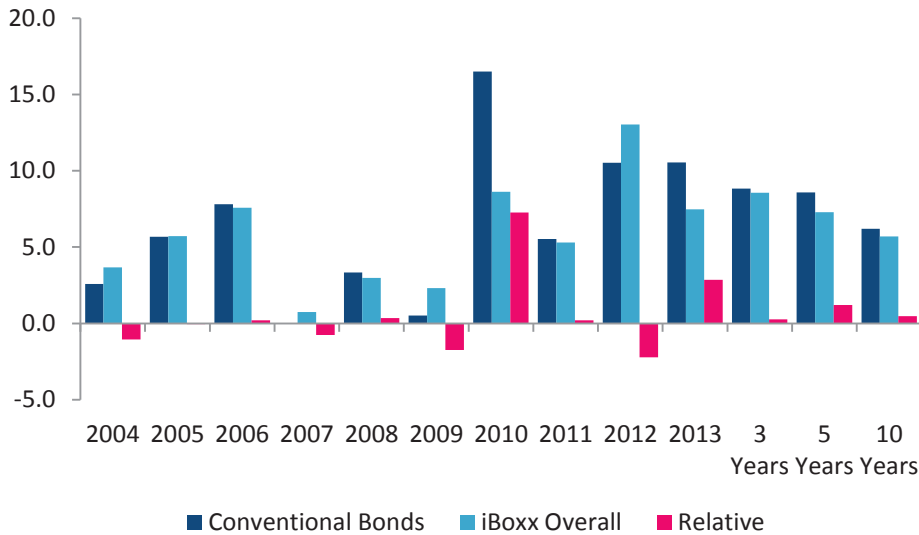
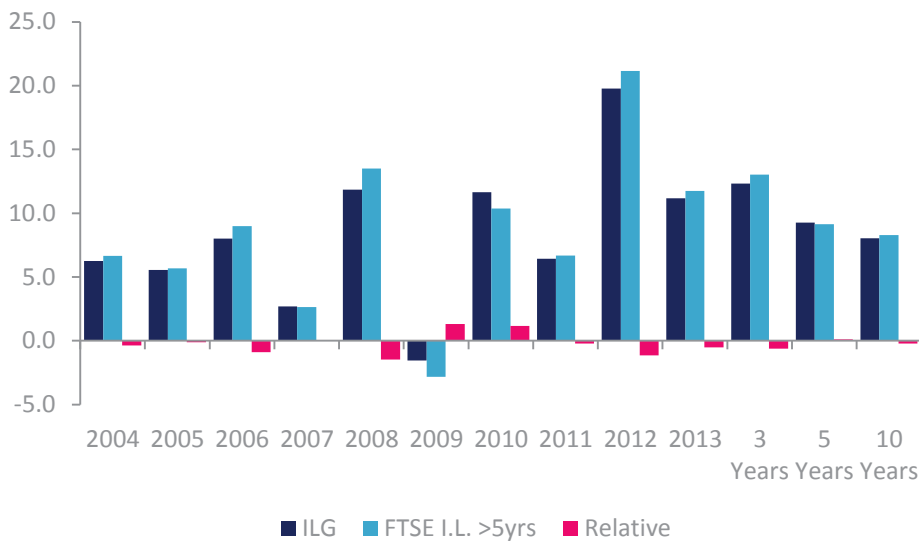


Chart 12: Index-linked bonds



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Cumulative performance

Chart 13: UK equities

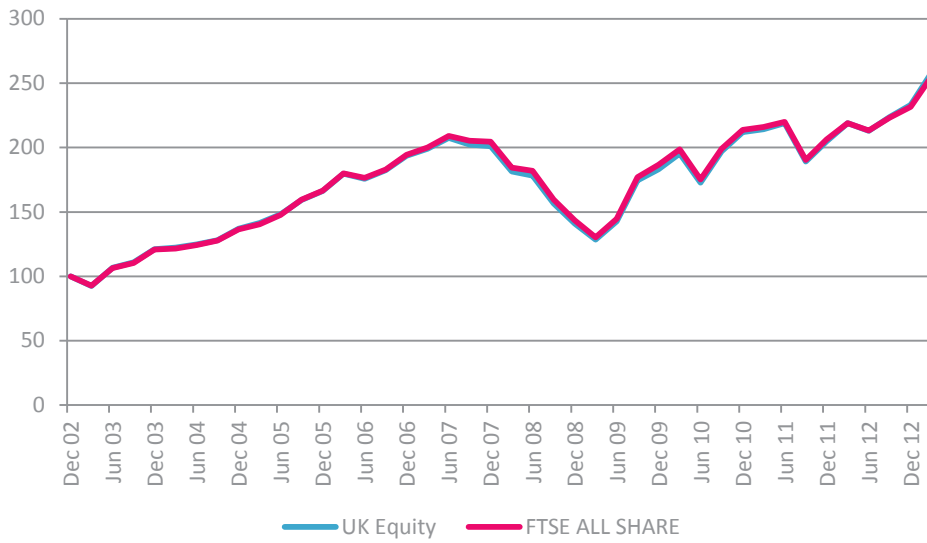
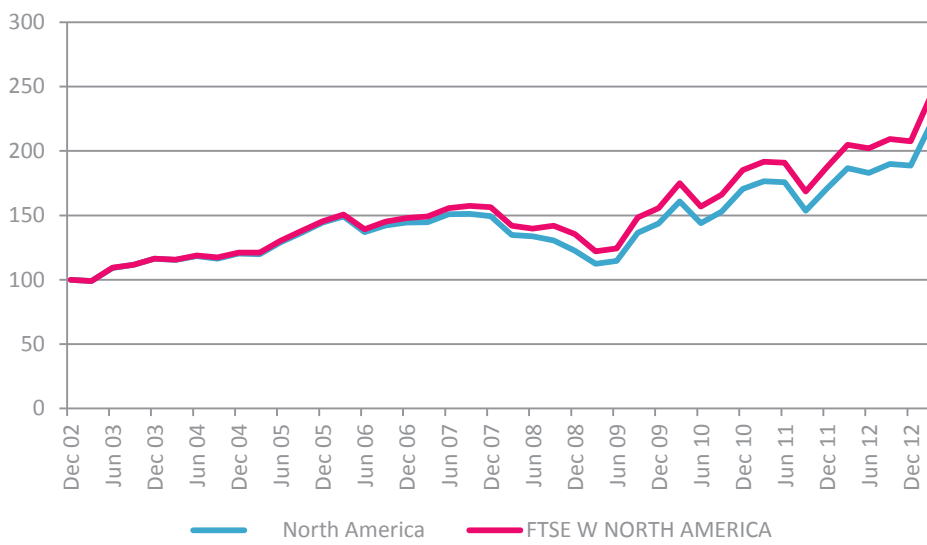


Chart 14: North American equities



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Chart A15: Europe ex UK equities

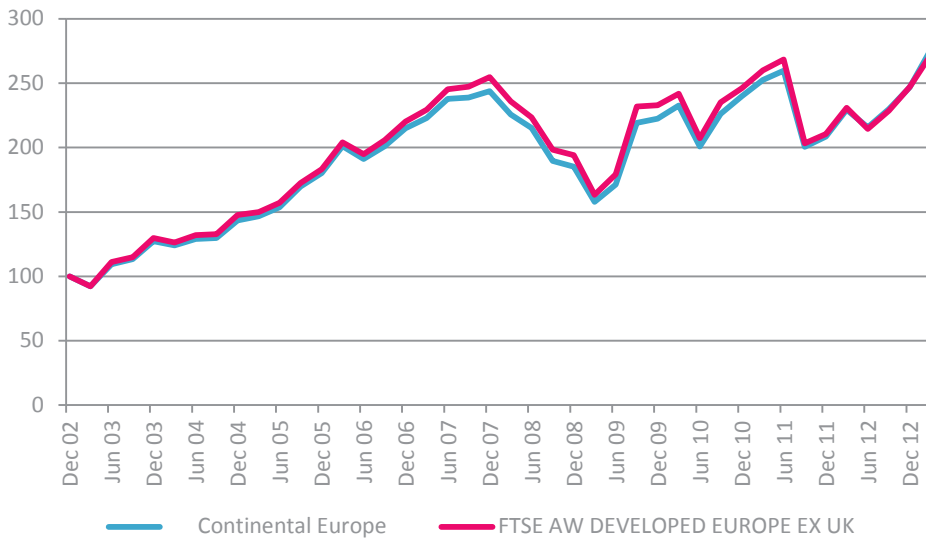
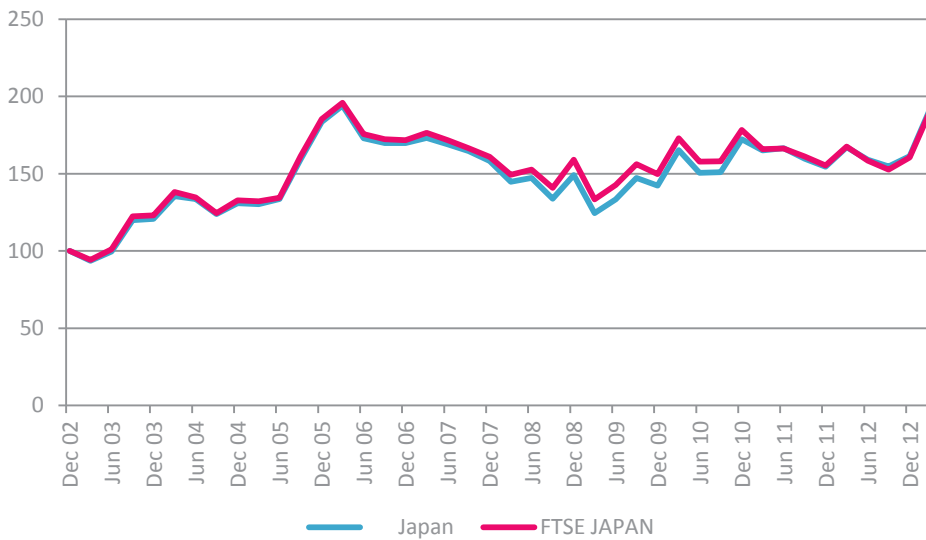


Chart A16: Japan equities



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Chart A17: Asia Pacific ex Japan equities

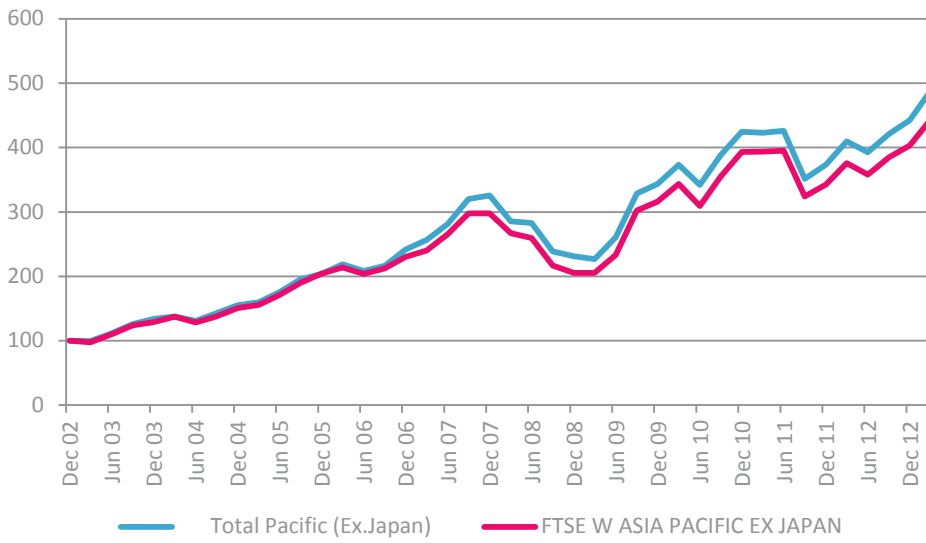


Chart A18: Emerging markets equities

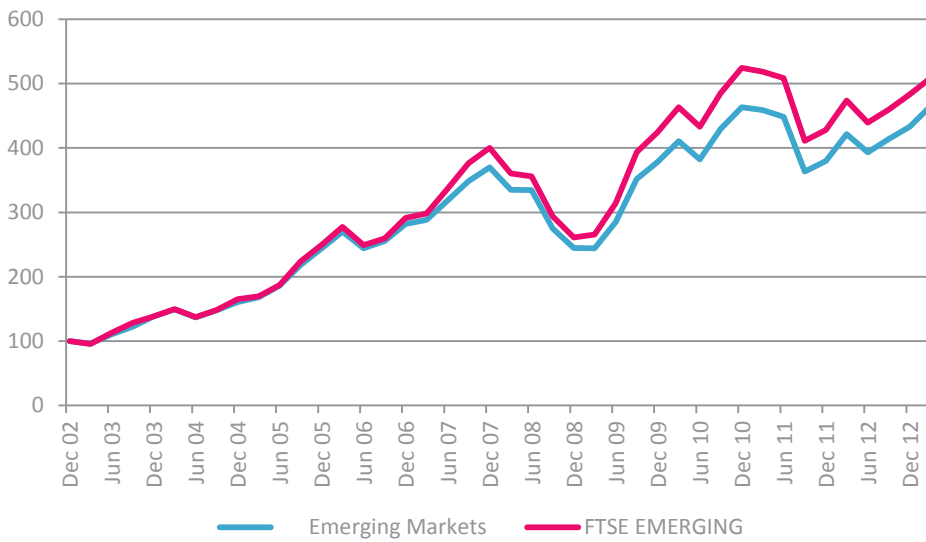


Chart A19: Conventional bonds versus government gilts and corporate bonds

Since mid-2009, funds have typically held less in gilts and more in corporate bonds than the benchmark index and have typically held lower grades of corporate bonds than the index

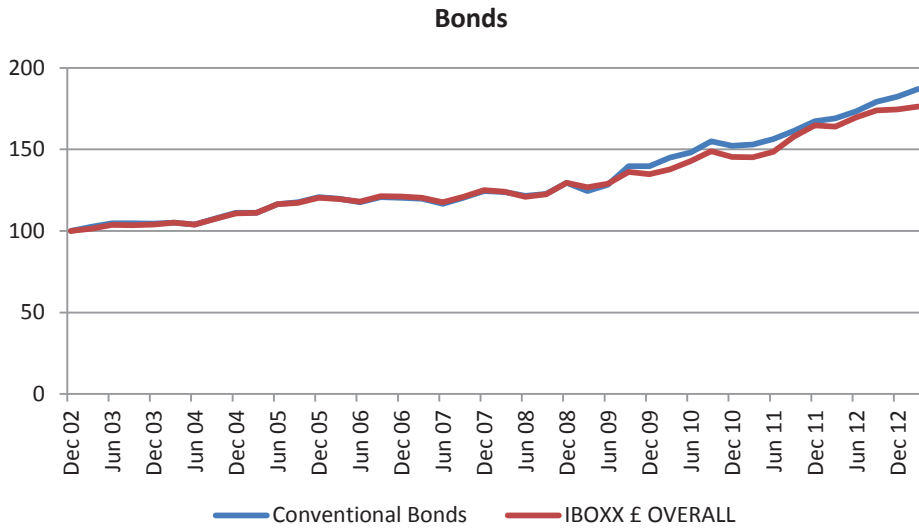
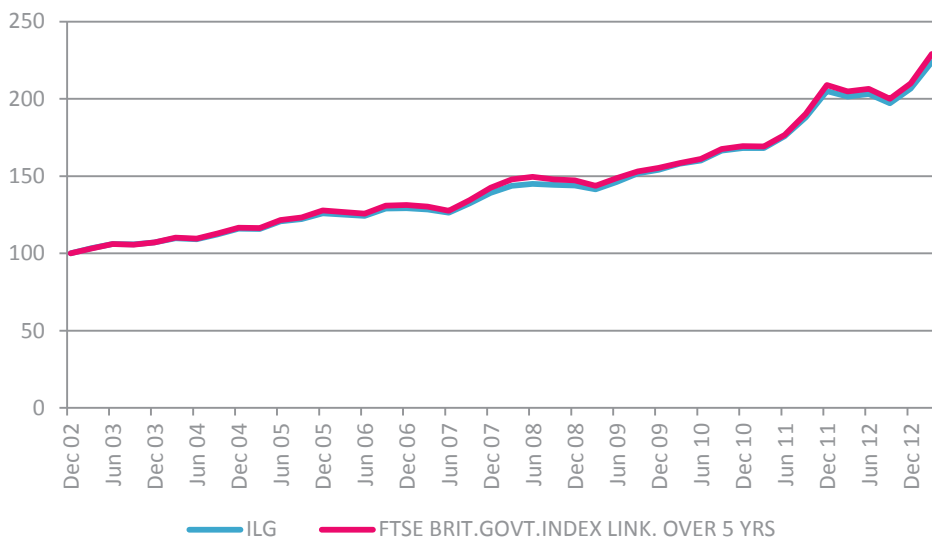


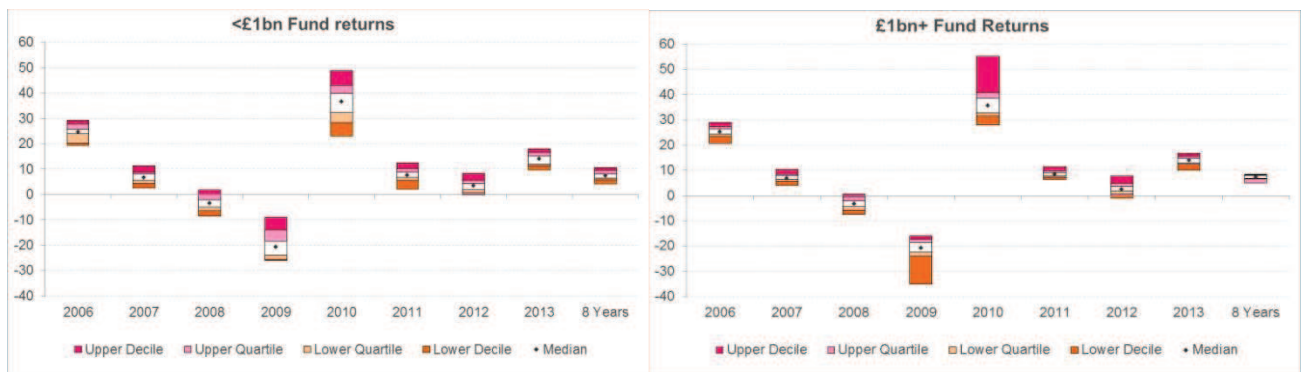
Chart A20: Index-linked gilts



Appendix 2b LGPS performance dispersion, small and large

All of the Fund performance data used in this Appendix is based on data gathered by Hymans Robertson from data in the public domain (e.g. Funds' annual reports and accounts).

The leftmost bars in each of the charts below shows the spread of returns in each financial year from 2005-06 to 2012-13, indicating the top 10, top quartile, median, bottom quartile and bottom 10. The rightmost bar shows the spread of returns for the cumulative 8-year period. The chart on the left includes all of the LGPS funds that are less than £1bn and the chart on the right is the funds over £1bn.



The median return over eight years for the smaller funds was 7.2% p.a. and for the larger funds it was 7.4%. Although there is no strong evidence of better performance by larger funds there is evidence of a wider dispersion of returns for the smaller funds, particularly in the critical years, 2008/09 and 2009/10 around the credit crunch.

Characteristics of funds in the top 10

- These funds use a limited number of managers (typically 1-3 managers with balanced mandates focused on equities and bonds);
- They retain their managers for the long term, even through inevitable periods of underperformance;
- They adopt a simple structure focused on equities, bonds and property;
- They make limited use of alternatives;
- Some use internal management; and
- There is evidence they rebalanced assets back to benchmark over 2008/09 as equity markets collapsed; this enabled full participation in the equity market rebound in 2009/10

Appendix 6a Analysis of available fund structures for one or more common investment vehicles Squire Sanders

1 EXECUTIVE SUMMARY

1.1 This section of our Report is in three parts:

- (a) a legal analysis of the Investment Regulations and the restrictions contained in them on five English law CIV structures which may be held by LGPS funds;
- (b) an analysis of the key regulatory and tax features of those CIVs; and
- (c) a summary of the procurement and potential competition law implications of LGPS funds subscribing for investments in new CIVs.

1.2 A Glossary of terms used in the Executive Summary and the analysis is found at the end of Section 1. It should be noted that our conclusions are based on the law as it currently stands at the date of this Report. The law may and no doubt will change and evolve and therefore care should be taken to ensure our conclusions remain valid in that event.

Investment Regulations

1.3 The Investment Regulations currently constrain LGPS funds' investment powers by reference to some but not all of the available structures and do so by reference to the legal form of the vehicle. Those Regulations impose maximum holding limits of between 30% and 35% and may limit investments in other vehicles which are not expressly mentioned in the Regulations by virtue of a single holding limit of 10%. These limits can be repealed or amended by secondary legislation under powers given to the Secretary of State by the Superannuation Act 1972.

1.4 The power of investment of an LGPS fund is vested in the administering authority ("AA"). As such, since there is no power for another person, such as the Secretary of State, to exercise that function or direct how the power is used. AAs cannot be compelled to exercise their discretion to invest in a CIV (or any other instrument). The legislative means by which such a power could be given to another body is also by secondary legislation under the same Act.

Summary of CIV key features

1.5 The key features of each of the five CIVs (a Unit Trust (UT), Open Ended Investment Company (OEIC), Limited Partnership (LP), Authorised Contractual Scheme (ACS) and Unit Linked Life Fund) have been analysed on the assumption that new vehicles might be set up which could be tailored to LGPS funds (and any private sector funds which chose to invest in such funds). It may be that an existing insurance company could offer existing unit linked life funds or create new unit linked life funds for these purposes, which would save time and potentially capital, especially since three of the major players in the passive management field (Legal & General, BlackRock and State Street Global Advisors) each have current LGPS assets under management in such funds. We have not considered the implications of using existing vehicles in this Report nor have we carried out any due diligence on any such vehicles, so this is no more than a factual observation. There are also potential competition and procurement law issues which need to be addressed.

1.6 Because of the way that the Investment Regulations currently require OEICs to be authorised as UCITS compliant funds to maximise an LGPS fund's holdings in any single OEIC, we have assumed that only

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such an authorised and UCITS compliant OEIC fund would be established. Although the regulatory régime is different, a comparable analysis necessarily applies to a unit linked life fund, because there is only one financial services model available.

- 1.7 The same regulatory hurdle of being UCITS compliant does not apply to the other vehicles (i.e. UTs, LPs or ACS), at least as far as the way the Investment Regulations restrict their usage. That is not to say that these vehicles can be used in a completely unregulated way, since the manager/operator and the depositary must be authorised under the AIFMD. The complexity of the financial services authorisation options for each of these vehicles is beyond the scope of this Report, but in summary, each collective investment scheme established under either section 235 or 235A of the Financial Services and Markets Act 2000 may be established on a number of different bases, broadly depending on the type of investor that the scheme is aimed at. UCITS may be marketed to retail investors but are accessible by professional investors also (i.e. including LGPS funds).
- 1.8 There are further categories of authorised fund which benefit from less rigorous rules which could be used for professional investors such as LGPS funds: these include the Non-UCITS Retail Scheme ("NURS") and the Qualified Investor Scheme ("QIS"). We have assumed for the purposes of this Report that the last of these vehicles, the QIS, is the most appropriate model to use for UTs, LPs and ACS, since it preserves the maximum flexibility and has the least regulatory burden. If further analysis of the UCITS and NURS options is required, we can of course revise our advice.
- 1.9 The broad parameters of our analysis are set out below; more detailed discussion is found in the table in the Annex.
- 1.10 There are, in the final analysis, a limited number of distinguishing features which would lead to the conclusion that a particular legal model is superior to the others.
- (a) **Regulator** - under each CIV there is a need for authorisation under FSMA. For a unit trust, OEIC, LP and ACS the regulator will be the FCA. For unit linked life funds the prudential regulator, the PRA, supervises insurance companies. The life company regime is more complex than the supervisory regime for the other CIVs.
 - (b) **Timing** – whilst it is difficult to put an estimate on preparation time, the timescales for authorising an investment or fund manager are significantly shorter than establishing a new insurance company. Setting up a new unit-linked fund, however, involves comparable if not shorter timescales than for a new fund under the other structures. Use of existing vehicles (if appropriate) will of course reduce timing considerably.
 - (c) **Regulatory Capital** – regulatory capital requirements for life companies are significantly higher than for fund or investment managers. The regime is more complex and subject to change due to Solvency II in 2016 (with full implementation expected by 2019).
 - (d) **Ownership of the underlying assets** - of the five vehicles the OEIC and the life company vehicles each represent structures by which the legal and beneficial ownership of the underlying assets is separated from the investors (i.e. LGPS funds). In a UT, the trustee owns the assets on trust for the investors. In both the LP and the ACS legal ownership of the underlying assets remains with the CIV (because it has no separate legal personality from that of its investors). In all cases the CIV will contract with third parties through the operator of the CIV.

The retention of legal ownership under the LP and ACS models does not, however, mean that the investors control the underlying assets, since day to day control of the securities or other investments is a function which will need to be delegated to an authorised third party, ie a

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custodian bank (called a depository). Indeed, partnership law prevents limited partners from playing any part in management of an LP without losing limited liability status.

- (e) **Tax transparency on the underlying assets** – The LP and ACS models are the only vehicles that have tax transparency as a key feature of their design. Separate regimes exist for authorised UTs and OEICs. A life company owns its assets and benefits from a general exemption from tax on its pension fund business.
- (f) **Stamp Duty/SDRT** – All vehicles have favourable stamp duty tax treatment on transfers within the CIV. There is no distinction between stamp duty liability on purchases of equities and real estate by the CIV: all are subject to stamp duty although the initial transfer of securities into an ACS has been granted a specific exemption.
- (g) **VAT** – Authorised OEICs have favourable VAT regimes with no VAT on management fees. Insurance services are VAT exempt and irrelevant to an internally managed unit-linked life fund in any event. The UT, LP and ACS models also have favourable VAT exemptions.
- (h) **Withholding taxes (WHT)** - a detailed analysis of the efficiency of each vehicle to recover WHT on overseas investments is beyond the scope of this Report because it will depend on where the underlying assets are held. There may be differences in certain jurisdictions because of the recognition of the legal form of the CIV.
- (i) **Counterparty risk**- a key consideration is what rights investors have in the event of insolvency of the provider/operator of the CIV since that is the counterparty (the insolvency risk attaching to underlying issuers of securities held by the vehicle is of course the same regardless of the vehicle). The only CIV that has a separate insolvency regime is that which applies to insurance companies, by which eligible policyholders are given priority over unsecured creditors. None of the other vehicles offers this preferential creditor status as the LGPS investor would be unsecured in the absence of express security being granted by the CIV (this would not legally be possible in an LP or ACS anyway, given that those vehicles have no separate legal personality) . In a UT, OEIC, LP or ACS where the assets are held by a depository, the counterparty exposure is really therefore to the depository holding the assets.

Note that the Financial Services Compensation Scheme is not available to LGPS investors.

- (j) **Segregation of liability at a sub-fund level** – UTs, LPs and unit linked life funds do not offer segregated cells or sub-funds, meaning that the assets and liabilities of one sub-fund could suffer contagion if another sub-fund were to default. OEICs and ACS contractual schemes offer sub-fund options and segregation recognised under insolvency laws.
- (k) **Investment objectives and restrictions** – because of the manner in which the Investment Regulations treat an OEIC (i.e. as a UCITS which has a maximum investment holding of 35% by an LGPS fund), that vehicle is disadvantaged in terms of its investment restrictions. Unit-linked life funds may only be provided on a regulated basis and so are also subject to permitted links rules which prescribe the assets that can be used to count against the solvency capital of the insurer. The UT, LP and ACS can all therefore benefit from more investment freedom than is prescribed under the UCITS directive.

- 1.11 Procurement** – The potential concentration of assets under a new CIV or CIVs needs careful analysis to ensure that the procurement law impact of the establishment of new CIVs is not under-estimated. The identity of the operators of any new CIVs and the nature of the vehicles will determine these questions. We have therefore described in outline the parameters of public procurement by reference to the CIVs discussed in this Report.

GLOSSARY

ACD	Authorised Corporate Director (of an ICVC or OEIC)
ACS	Authorised Contractual Scheme established pursuant to the ACS Regulations
ACS Operator	the person authorised under FSMA to manage an ACS
ACS Regulations	Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013
AFM	Authorised Fund Manager (meaning a legal entity authorised under FSMA to manage a fund)
AIFM	Alternative Investment Fund Manager (to be authorised by FCA effective 22 July 2014)
AIFM Regulations	Alternative Investment Fund Managers Regulations 2013
AIFMD	Alternative Investment Fund Managers Directive
AUT	Authorised Unit Trust (meaning authorised by FCA)
CIS	a collective investment scheme under section 235 FSMA (including OEIC, UT, ACS, UCITS and UCIS)
CIV	a CIS and unit-linked life fund or pension fund management insurance contract
COLL	FCA's Collective Investment Schemes handbook of rules and guidance
Depository	the name for the custodian of the ICVC (FCA and/or PRA authorised)
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
Investment Regulations	LGPS (Management and Investment of Funds) Regulations 2009
ICVC	Investment company with variable capital established pursuant to the Open-ended Investment Companies Regulations 1997
LP	Limited Partnership
NAV	Net Asset Value
NURS	Non-UCITS Retail Scheme (which can be either an ICVC or UT)
OEIC	generic name for ICVC
PAIF	Property Authorised Investment Fund, a regulated ICVC principally intended for property investment (structured as a NURS – not a UCITS)

2 IMPACT OF THE INVESTMENT REGULATIONS ON CIV STRUCTURES

INTRODUCTION

The Investment Regulations impose, under Regulation 14(2) and Schedule 1, various restrictions on different types of investment vehicle. Those limits may be increased if the AA complies with Regulations 14(3) and 15. For the purposes of this report and all of the options, the collective investment vehicles ("**CIVs**") that most readily allow for pooling of assets are as follows.

Vehicle	Maximum Limit % of Fund
Limited Partnerships (" LP ")	30%
UTs managed by one body	35%
OEICs managed by one body	35%
UT/OEIC managed by the same body	35%
Any single unit-linked or pension fund management insurance contract	35%
<p>Notes:</p> <p>1 The 35% restriction does not apply if the unit trust or OEIC invests, inter alia, in gilts.</p> <p>2 An OEIC is defined by reference to the UCITS Directive, so an unauthorised investment company which does not comply with that Directive is subject to a separate lower limit which applies to unlisted securities of 15%.</p> <p>3 In reality, a life insurance contract would have to be unit linked rather than a pension fund management contract as the latter is designed to be used for a discretionary investment management portfolio and would not be capable easily (if at all) of being issued in joint names of such investors.</p> <p>4 All of the above limits apply at the time of the original investment. There is no comparable ongoing maximum requirement if, for example, the value of the holding increases by reference to other asset classes.</p> <p>5 The Investment Regulations also make reference to the ability for LGPS funds to coinvest in a scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961 "without any restriction as to quantity". To our knowledge only one such scheme has ever been approved (a CCLA property fund which holds approximately £80m of assets). We have not considered this apparently arcane power further as the regulatory framework is unclear.</p>	

- 3.8 The consequence of this requirement to categorise investment vehicles by legal type and whether or not the investment is listed or not will of course have a direct bearing on the number of different CIVs that an individual LGPS fund may invest in. The lowest number of CIVs that an LGPS fund may already currently invest in is three (using the 35% limit applicable to unit trusts, OEICS and life company funds).

Conclusion

- 3.9 In conclusion, it is possible to circumvent the limits and have an undiversified portfolio, with heavy concentration of asset and counterparty risk under the current regulatory framework. Whatever outcome is decided upon as a result of this Report, one key recommendation we would make is to reconsider the efficiency of the Investment Regulations in controlling risk, as the asset allocation limits in Schedule 1 do not do this in any sophisticated way and lead to additional expenses in many instances to use vehicles which circumvent Schedule 1 limits.

4 ANALYSIS OF CIV STRUCTURES

- 4.1 Leaving aside the maximum limits imposed by the Regulations, not all CIVs have the same governance, capital or tax features. A number of more fundamental complex factors are set out in the matrix in the table below. For instance, is it more important to have CIVs which have maximum investment freedom or is the governance and tax structure more important? Is it important for investors to own the underlying assets and not have to assert a contractual right against the CIV in the event of an insolvency of an underlying investment? Such questions need to be tempered by a realistic understanding of the legal rights on counterparty default.
- 4.2 We have not attempted to score the factors that we have identified as applying to each vehicle in terms of investor suitability but that could of course be done.
- 4.3 We have limited the analysis to those CIVs referenced in the Investment Regulations and the ACS alternatives. This is not because other CIVs are not eligible investments for LGPS, but simply because their treatment under the Investment Regulations is that the lower 15% investment limit applies for such entities if they have to be regarded as investments in unlisted securities (where the limit is 15% in aggregate) or the 10% single holding limit (unless they fall outside the Investment Regulations altogether).

5 IMPACT OF THE AIFMD

- 5.1 AIFMD was implemented in the UK with effect from 22 July 2013 by the AIFM Regulations. It effectively implements a new regulatory (EU-wide) regime for alternative investment funds, where previously regulation had either not existed at all or had focussed on certain activities of certain participants involved in the setting up and running of an alternative investment fund.
- 5.2 An AIF is very broadly defined in the AIFM Regulations. It includes all alternative investment funds other than UCITS. Therefore, it would include all of the CIVs considered in the Table, save for an OEIC established as a UCITS fund and a life company fund. The consequences of each of the non-UCITS funds falling within AIFMD's remit are that detailed new regulation of the vehicle, manager and third parties will apply (through FCA's "FUND" sourcebook) with effect from 22 July 2013. It is not possible to evaluate whether the costs associated with the new regime will outweigh those attributable to existing UCITS or life company regimes. The extent to which these new rules may cause significant extra cost will also depend on whether the supporting parties are AIFMD compliant at their own cost or whether AIFMD compliance becomes part of the set up cost of a new CIV.
- 5.3 There is a pension specific exclusion in recital 8 of AIFMD which provides that it "should not apply to the management of pension funds... [by] local governments and bodies or institutions which manage funds

supporting social security and pension systems...". This means that although AIFMD does not apply to the LGPS funds themselves, it does apply to any CIV which is not a UCITS (and not a unit-linked life fund).

6 PROCUREMENT LAW ASPECTS

Introduction

6.1 Public procurement of investment-related services will obviously add time and cost to the establishment of any new CIV. For that reason alone it is necessary to assess how the procurement rules apply, let alone the risk of challenge that either the procurement rules have not been applied properly or that they have simply been ignored when they should have been applied. This is a complex area of the law on which Counsel's opinion should be sought.

6.2 The administering authorities of LGPS funds are covered by the Public Contracts Regulations 2006 ("PCR") as contracting authorities. They are therefore subject to EU procurement rules. This means that, unless there is a relevant exemption in the PCR, the appointment of any new investment manager or the entering into a new investment arrangement requires a public procurement exercise to take place in accordance with those rules⁸.

Application to investing in a CIV

6.3 There is, however, a widely used exemption in Regulation 6(2)(h) of the PCR which provides that, where a contracting authority enters into a contract which is: "for financial services in connection with the issue, purchase, sale or transfer of securities or other financial instruments, in particular transactions by the contracting authorities to raise money or capital", then no public procurement exercise needs to be followed. This exemption merely applies to the direct purchase of investments by a contracting authority, not where a discretionary investment management service is provided.

6.4 The word "securities" is not defined in the PCR, nor is it defined in the European Directive on procurement (2004/18/EC). However, the natural meaning of "securities" when used in other contexts is a wide one and we do not believe that it should be construed narrowly in a technical sense. Hence the fact that a unit trust, for example, does not issue shares, but units, should not be taken to mean that a subscription for units in a unit trust would not fall within the exemption. Shares issued by an OEIC are more obviously to be regarded as securities. Even if the relevant financial services contract is to purchase "other financial instruments", (a phrase which is also not defined) rather than securities, those words should be wide enough to capture unitised investments and would therefore apply to unit trusts as well as unit linked life assurance contracts.

6.5 In principle, we see no reason why this analysis should not also apply to the tax transparent forms of CIV, i.e. the limited partnership and the authorised contractual scheme established on a tenants in common basis. If all the AA is doing is buying an interest in such a CIV, the analysis should be the same as for the other forms of CIV, despite the fact that it is less clear that the limited partnership or ACS either issues or sells "securities" or "other financial instruments".

6.6 It is a completely separate consideration whether, notwithstanding any technical argument that Regulation 6(2)(h) removes the need for a procurement exercise on subscribing for interests in a CIV, it might nonetheless be desirable to do so in the interests of public transparency.

Services procured by and provided to the CIV

6.7 The legal structure and ownership of the CIV will determine whether it or its investors (i.e. the administering authorities of LGPS funds) are also involved in procuring additional services which are

⁸ **There is a general exemption which applies a de minimis threshold which would be irrelevant in the current circumstances, given the value of potential investments in a new CIV.**

caught by the PCR. As stated above, the PCR only applies to public bodies which are contracting authorities. Therefore, this governance feature of the CIV is extremely important. If the operator of the CIV procures all of the external services and that operator is a private sector body, then the PCR will not apply to it and accordingly the full extent of public procurement rules will also be excluded. However, to the extent that the administering authorities retain control over the provision of services to the CIV via the governance structure of the CIV, there is a clear risk that each of the parties exercising that control will be subject to procurement rules. The services to be procured by a CIV could include those of a discretionary fund manager, the depository (custodian) and the administrator (if that is a different party from the depository), and other advisers such as auditors.

Governance/ownership issues

- 6.8 There is one other consequential issue which relates to the governance structure and who provides services to the CIV. This concerns the ability to apply "internal" or "in house" procurement exemptions, which derive a line of European Court judgements beginning with the Teckal case. This is a growing and developing area of the law which may also be affected by the new European Directive on procurement which is due to come into force in 2014. Without further understanding of exactly how a CIV might be established and the degree to which any private sector party might play a role in that structure is impossible to comment on the application of any such exemption, but a further analysis of the procurement implications may be necessary in due course.

7 STATE AID / EU LAW

State aid

- 7.1 Article 107 (1) of the Treaty on the Functioning of the European Union ("TFEU") establishes a general prohibition on State aid within the EU. A State measure will constitute State aid, and will in principle be prohibited, if it satisfies all four of the following criteria:

- (i) The aid is granted by a Member State or through State resources;
- (ii) The aid confers an advantage on the recipient by favouring certain undertakings or the production of certain goods;
- (iii) The aid distorts or threatens to distort competition; and
- (iv) The aid affects trade between Member States.

The four criteria are cumulative, i.e., all four must be met for the measure to constitute State aid. In the absence of any one of them, the measure is not classified as State aid pursuant to Article 107(1) TFEU.

- 7.2 Investment in the CIVs can therefore not give rise to State aid in the absence of an element of selectivity, i.e., the grant of a selective advantage within the meaning of the second limb of the State aid test (above). In addition, any selective advantage that could be identified would also have to be capable of distorting competition. In the scenarios envisaged, it is unclear whether any actual or potential competition in the market could be distorted. This would depend on the choice of an ultimate CIV model or models.

Fundamental principles of EU law

- 7.3** The implementation of Options 1 or 2 must not infringe fundamental principles of EU law, including in particular the prohibition on discrimination (Article 18 TFEU) and the free movement of goods, services, persons and capital within the internal market of the European Union (Article 26 (2) TFEU). Further detailed analysis may be required in order to ensure that the use of CIVs in practice does not give rise to potential claims that non-UK investment vehicles are suffering discrimination or exclusion in breach of these principles.

Annex: Detailed Comparison of CIVs

Note: Please see Executive Summary for an explanation of why we have concluded that the Qualified Investor Schemes (QIS) model would be the optimum vehicle for each of the UT and ACS models, whether established (on an LP or tenants in common basis).

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
Nature of Legal Structure (relevant to features such as ownership of assets, who contracts on behalf of CIV, who is able to sue/be sued)	Trust established by trust deed, entered into by the manager and the trustee. Established under trust law.	Corporate established by instrument of incorporation under the OEIC Regulations.	Partnership deed established under Limited Partnerships Act 1907 and COLL.	Contractual Scheme established by deed and COLL.	Corporate under Companies Act 2006 or alternative mutual structures.
Ownership of Assets	Assets owned by trustee. Investors have beneficial interest as unitholders. Trustee contracts on behalf of unitholders.	Assets owned by depositary. Investors are shareholders. ACD as director of OEIC enters into contracts.	Assets held by depositary. Investors are limited partners acting through general partner (GP) as legal owners. NB - Investors lose limited liability if they become involved in management.	Assets held by depositary; beneficially by investors as tenants in common.	Insurer is legal and beneficial owner of property and contracts with third parties. Investors have contractual rights as policyholders.

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
AUTHORISATION ISSUES					
Collective Investment Scheme for FSMA purposes?	Yes	Yes	Yes	Yes	No
Which parties require authorisation by FCA?	Manager Trustee	Manager/ACD Depositary	Operator/Manager Depositary	Operator/Manager Depositary	Insurer (may delegate to separately authorised Manager).
Threshold conditions requirement for authorisation of Manager/Operator by FCA?	COND 2: Location of offices, effective supervision, appropriate resources, suitability, adequate business model	As UT	As UT	As UT	As UT, but additional life company authorisation rules apply.
Required personnel/ controlled functions for Manager/Operator.	Personnel performing controlled functions (e.g. director, investment manager, compliance officer, money laundering reporting officer) must be fit and proper (includes financial solvency, honesty and	As UT	As UT	As UT	As UT, although insurance company personnel will have different skill set requirements.

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
	competence/ capability). Personnel to be in place on authorisation. Significant requirements on competence from regulators where advising / managing activities undertaken (effectively degree level plus ongoing CPD requirements).				
Does CIV (and any sub-fund) require authorisation?	No	Yes	Yes	Yes	Only at insurance company level but substantial regulatory oversight and attention (e.g. see TR13/8 thematic review by FCA into governance of unit linked funds).
Other authorisation features		Depositary must be independent of the OEIC (and the ACD).	Depositary must be independent of the Manager.	Depositary must be independent of the Manager.	Full regulatory oversight of capital, systems and controls and conduct of business.

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
Timescales for CIV authorisation NB need to factor in time to recruit staff with appropriate qualifications for all CIVs if starting from scratch	Timescales extended depending on nature of QIS – can be 3-4 months.	As UT NB ACD authorisation likely to take longer as specific roles and responsibilities under COLL and OEIC regulations require specific expertise.	As UT	As UT	6 to 12 months from submission of completed FCA application pack, considerable preparation time, so 12-18 months in total.
Timescale for sub-fund from authorisation	4-6 weeks	As UT	N/A. No sub-fund permissible – need separate LP	As UT	N/A. In practice sub-funds operate at an accounting level only by the insurer creating separate sections of their pension fund management business.
Capital requirements for establishment?	AIFM: <ul style="list-style-type: none"> Initial capital of at least Eur 125k; and If value of assets under management greater than Eur 250m then additional own funds requirement equal to 0.02% of the excess over Eur 250m 	UCITS/NURS: <ul style="list-style-type: none"> Initial capital of at least Eur 50k/125k (if holding client money) or Credit risk plus market risk calculation Fixed overheads 	As UT	As UT	Capital resources requirement made up of: <ul style="list-style-type: none"> base capital requirement (between Eur 700k and Eur 3.7m) risk-based capital requirements based on credit

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
	(subject to a Eur 10m cap) <ul style="list-style-type: none"> • Own funds must not be less than 25% of annual expenditure • Own funds may be reduced by bank guarantee or PI insurance in certain cases. 	25% relevant annual expenditure			risk, market risk, liquidity risk, operational risk and insurance liability risk
INSOLVENCY ISSUES					
Segregation of sub-funds' liabilities?	Umbrella schemes possible but not legally segregated at sub-fund level protection.	Protected cell regime provides that individual sub-funds can be legally segregated and protected from other sub-funds.	Not possible to have umbrella schemes, so no sub-funds segregation.	Umbrella schemes with sub-funds possible (see OEIC comments).	Segregation achieved at accounting level only.
Rights on Insolvency of CIV	Unsecured creditor	Unsecured creditor	Unsecured creditor (of underlying assets).	Unsecured creditor (of underlying assets).	Special creditor regime under Insurance Insolvency Directive gives policyholder preference over unsecured creditors.

INVESTMENT RESTRICTIONS					
<p>Investment restrictions on the vehicle?</p> <p>NB: Table contains a summary of the most relevant and important limitations for authorised CIVs (OEIC and life fund).</p>	<p>There is a basic requirement for a spread of risk consistent with the investment objective and policy but there are no specific spread or concentration limits, except in relation to property.</p> <p>The following are permitted investments for a QIS:</p> <ul style="list-style-type: none"> • Shares. • Debt instruments. • Deposits. • CISs. • Derivatives. • Contracts of insurance. • Government and public securities. • Property. • Precious metals (gold, silver and platinum). • Commodity contracts. 	<p>UCITS:</p> <ul style="list-style-type: none"> • May invest no more than 10% of its assets in transferable securities or approved money-market instruments which are issued by any single body and all holdings in excess of 5% of its assets may not, in aggregate, exceed 40% of the assets. • No more than 20% of scheme property may be in transferable securities or approved money-market instruments issued by entities in the same group. • No more than 20% of assets may be invested in any one single CIS (UCITS or non-UCITS), with a general restriction of a maximum of 30% of assets invested in non-UCITS schemes. 	<p>As UT</p>	<p>As UT</p>	<p>Permitted links rules apply:</p> <ul style="list-style-type: none"> • Must have in place appropriate valuation procedures • Permitted links must be via approved indices only <p>Permitted links include:</p> <ul style="list-style-type: none"> • Approved securities • Listed securities • permitted unlisted securities • permitted land and property • permitted loans • permitted deposits • permitted scheme interests • cash • permitted units • permitted stock lending • permitted derivatives

		<ul style="list-style-type: none"> • Maximum OTC derivatives, counterparty exposure is limited to 5% (10% in the case of approved banks). • No more than 20% of assets may be invested in a combination of transferable securities and approved money-market instruments issued by, and deposits or OTC derivative transactions made with, a single body. • No more than 35% of assets may be invested in the government or public securities of a single body (subject to the point below). • Over 35% of scheme property may be invested in a single government or public securities body, but there is a restriction that no more than 30% of 			<p>Note: the terms above have specific meaning in the FCA glossary. The detailed rules are designed to protect policyholders.</p>
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		the scheme property consists of securities of any single issuer and a requirement that the securities must come from at least six different issuers			
VALUATION ISSUES					
Valuation rules for investor interests specified by FCA?	<ul style="list-style-type: none"> The manager should exercise due diligence in connection with valuation and pricing, and show that it has complied with the minimum control requirements set out in the FCA rules. The Manager has a duty to ensure that prices used to value investments are correct and to take action to rectify any incorrect (including reimbursing or compensating investors). 	<ul style="list-style-type: none"> See UT for valuation rules for specified investor interests. Under the FCA rules, there is a set of minimum checks that a depositary must perform to satisfy itself that the ACD's pricing operation is adequately controlled and the risk of incorrect prices is minimised. 	As UT	As UT	Specific insurance company rules relating to valuation of assets.

<p>Valuation and Pricing of Assets</p>	<p>AIFM: at NAV Dual or single pricing Forward or historic pricing</p>	<p>At NAV Dual or single pricing Forward or historic pricing</p>	<p>At NAV Dual or single pricing Forward or historic pricing</p>	<p>At NAV Dual or single pricing Forward or historic pricing</p>	<p>At NAV Varied practices, including Forward or Historic pricing and priced on Dual or single basis FCA TR13/8 comments on pricing and valuation practices in unit-linked funds.</p>
<p>GOVERNANCE</p>					
<p>Governance Disclosure and reporting requirements</p>	<ul style="list-style-type: none"> • Legal and regulatory reporting requirements. • A prospectus – must comply with COLL content requirements. • AFM must publish the annual reports and accounts within four months of the end of the fund’s annual accounting period and the interim, or half-yearly, report and accounts within two months of the interim accounting date. 	<ul style="list-style-type: none"> • Changes to funds subject to COLL rules which determine how changes should be treated, and as a consequence, whether they require approval of FCA, unit holders or notifications. • Materiality of their impact will determine whether the change is to be treated as a pre- or post-notifiable, significant (pre-event notification) or fundamental (shareholder vote) 	<p>As UT</p>	<p>As UT</p>	<p>PRA / FCA oversight of governance regime. Substantial PRA reporting and preparation of ongoing capital, solvency, investment and general corporate governance.</p>

	<ul style="list-style-type: none"> • Long and short form report requirements • Changes to funds subject to COLL rules which determine how changes should be treated, and as a consequence, whether they require approval of FCA, unit holders or notifications. • Materiality of impact will determine whether the change is to be treated as a pre- or post-notifiable, significant (pre-event notification) or fundamental (shareholder vote) change. • Regime for merger and winding-up subject to regulator consent 	change.			
TAX ISSUES					
VAT Fund management charges	VAT exemption for management fees.	VAT exempt for management fees.	VAT exemption for management fees.	VAT exemption for management fees.	VAT exempt.

<p>Stamp Duty/SDRT on unit/interest/share purchases</p>	<p>Schedule 19 Finance Act 1999 imposes a stamp duty reserve tax; - the tax is charged on surrenders of a unit in an AUT to the manager.</p> <p>Schedule 19 is to be abolished by the Finance Bill 2014 and the tax will be payable until then.</p>	<p>See UT</p>	<p>The Stamp Duty and Stamp Duty Reserve Tax (Collective Investment Schemes) (Exemptions) Regulations 2013 provides specific exemptions from Stamp Duty and SDRT for transfer units within an ACS and transfers of securities to an ACS.</p>	<p>As ACS LP.</p>	<p>No SDRT or stamp duty on life funds – no change in beneficial ownership.</p>
<p>Withholding tax at CIV level on overseas securities</p> <p>NB Detailed analysis will depend on double-tax treaties to mitigate withholding taxes.</p>	<p>The UT may be subject to non UK withholding tax on its investments in non UK equities and debt securities.</p>	<p>As UT</p> <p>OEIC is beneficial owner hence similar to life company and may be able to rely on double-tax treaties.</p>	<p>Tax transparent so should be able to rely on treaty relief, but will depend on recognition of vehicle's tax transparency.</p>	<p>Tax transparent so should be able to rely on treaty relief, but will depend on recognition of vehicle's tax transparency.</p>	<p>Life company as beneficial owner may be able to rely on some quite long standing double-tax treaties.</p>

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the statutory alignment of funds to AAs is set out in primary legislation so can only be amended by further primary legislation.

2.3 It is important to distinguish between the terminology here: the body that is responsible for discharging the benefit obligation to the members (i.e. the AA) has a fund" or "funds" which is designed to be sufficient to do so. The AA has an obligation to invest the monies it receives and can do so, subject to the Investment Regulations, in a range of different vehicles or directly. The "fund" is therefore separate from the underlying investment vehicle and is an asset owned by the AA. In turn, the power of investment (and in fact duty to do so) is vested in the AA for its fund; it does not belong to nor is it delegated by the Secretary of State.

2.4 The key issues relate to whether:

- (a) the assets supporting current liabilities can be transferred under the control of other AAs or new statutory bodies; and
- (b) whether scheme liabilities may be transferred in the same way.

2.5 In turn this leads to the following questions:

- (a) does the Secretary of State have the power to compel mergers of assets and liabilities within existing vehicles only or would it be necessary and/or desirable to create new funds and/or AAs?
- (b) if the Secretary of State does not have the requisite powers and primary legislation is necessary, is there a suitable precedent that exists?

2.6 It is also necessary to look at other powers than those which govern the mere transfer of assets and liabilities. These include the degree of prescription which applies to current AAs under the existing LGPS and how scheme employers are mandated to adhere to a particular one of the 89 current LGPS Funds.

2.7 If the Secretary of State does possess the above powers already, or can reserve them to himself by means of making new regulations made under existing primary legislation, the next level of analysis is whether third parties, whose rights and obligations are not expressly covered under the statutory framework, can also have their obligations and rights transferred or assigned to apply to a new structure. We consider each of those issues in turn.

3 SUMMARY OF LEGAL DEPENDENCIES

Pre-condition to merger of funds	Pre-2014 legislative power (Primary or Secondary)	Post-2014 legislative power (Primary or Secondary)	Potential Legislative solution
Establishment of new Fund and new Authority	N/A	Section 3(1), 2013 Act	Regulations
Alignment of statutory functions of Act and requirement to maintain a fund	The "Appropriate Fund" is designated by Regulation 29 and Schedule 4 of the 2008 Regulations	Regulation 53 and Schedule 3 of the 2013 Regulations identify the bodies who are required to maintain a pension fund and are therefore AAs	Regulations - would be required to amend these provisions if the AAs were to change.
Allocation of employers to the new fund	The "Appropriate Fund" is designated by Regulation 29 and Schedule 4 of the 2008 Regulations	Scheme employers are designated by Part 2 of Schedule 4 of 2013 Regulations	Regulations - would be required to amend these provisions if scheme employers were reallocated.
Transfer of existing fund (assets only) to new Authority	"Amalgamation" under Schedule 3, (Para 2) 1972 Act	Section 3(1), 2013 Act and Schedule 3 Broad power to make regulations in relation to schemes - not specific	Regulations
Transfer of past liabilities to the new Authority	"Amalgamation" under Schedule 3, (Para 2) 1972 Act	Schedule 3, paragraphs 11 and 12 of the 2013 Act permits regulations for administration, management and winding up and for nominating who must provide benefits.	TBC. Regulations may be made by the Secretary of State
Novating existing admission agreements and supplier contracts (these will include the current AA as a party)	N/A [<i>Existing Admission Agreements saved by Transitional Regulations</i>]	Section 3(2) 2013 Act consequential etc power, may be sufficient.	Regulations would be needed to novate all admission agreements wholesale and any supplier contracts to the new fund.

4 POWERS TO FACILITATE THE MERGER OF LOCAL GOVERNMENT PENSION FUNDS

- 4.1 The 1972 Act gives the Secretary of State the power to make regulations to provide pension arrangements for persons employed in local government service. Regulations were subsequently made to confirm the then applicable and subsequent benefit structures.
- 4.2 The 2013 Act (which applies to all public service pension funds, not just the LGPS) changed the benefit structure for the LGPS from 1 April 2014 and created new powers in respect of contributions from scheme employers and employees, albeit that those funding powers largely replicated the 1972 Act powers.
- 4.3 It should be noted that the investment powers of the LGPS funds have not been changed by the 2013 Act, so the only powers and duties AAs have are given under the 1972 Act.

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- 4.4 This means that there is no pre and post 2014 distinction between the funds held by the AA and the benefit obligations due to the members. Where an AA decides to use its statutory powers to establish a separate fund for particular employers by virtue of Regulation 32 of the 2008 Regulations and/or Regulation 54 of the 2013 Regulations, it is within the AA's discretion to do so. This is the only mechanism by which liabilities for particular employers are separately identified and hypothecated. The legislation does not operate so as to ringfence the affected members' rights to benefits⁹.
- 4.5 This principle is reinforced by the language of Regulation 86 of the 2008 Regulations (mirrored in Regulation 103 of the 2013 Regulations) which makes it very clear that any given member is to be identified, for funding purposes, as having an "appropriate fund".
- 4.6 A further nuance of this lack of correlation between a member's benefits and funding is that while the benefits are effectively guaranteed at the level of the LGPS as a whole, the rights of the member can only be asserted against the responsible AA for the relevant fund. For example, a member who paid contributions to a London borough fund cannot bring a claim against a metropolitan AA (and nor can the London borough fund itself). As evidence of this principle see Regulation 96 of the 2013 Regulations ("*the relevant transfer (to another scheme) may only be paid by the administering authority from its pension fund*"). This issue was examined in a judicial review brought by South Tyneside Metropolitan Borough Council where it was held that liability of the employer to contribute to a deficit in the Northumbria CC Pension Fund had not been transferred as a result of a restructuring (see further below).

1972 Act powers: detailed analysis

- 4.7 The general power to establish superannuation schemes for employees in local government service is set out in section 7 of the 1972 Act in the following terms:

"The Secretary of State may by regulations make provision with respect to the pensions, allowances or gratuities which, subject to the fulfilment of such requirements and conditions as may be prescribed by the regulations, are to be, or may be, paid to or in respect of such persons, or classes of persons, as may be so prescribed"

This power does not appear to place any limits on the scope of regulations that may be made under the Section 7 power. In fact, virtually all of the secondary legislation passed for the purposes of the reorganisation examples we cite below, was made under this Section.

- 4.8 Notwithstanding the power in Section 7, Schedule 3 of the 1972 Act details the specific provisions which may be included in regulations for local government pension arrangements.

- (a) Paragraph 2 of Schedule 3 provides that:

"Regulations may [provide] for the establishment and administration of superannuation funds, the management and application of the assets of such funds, the amalgamation of all or any of such funds, and the winding-up, or other dealing with, any such fund."

The terms "amalgamation" and "winding-up" are not defined in the 1972 Act and do not appear to have been considered further by the Courts in this context, nor has the definition been clarified in other legislation. Consequently, we have to apply an ordinary construction to those words. The word "fund" is not defined and would, we suggest, normally refer to the assets only of the relevant arrangement, without including the concept of the liabilities. This is a vital point

⁹ **As an aside, members' rights to benefits are not hypothecated by reference to particular assets (with the exception of AVCs) although even where, legally, any money purchase AVCs will be held in the name of the AA, not the member.**

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of construction and is not free from doubt. However, because benefits are guaranteed and not dependent on a given level of funding, there is no reason to suggest otherwise.

"Amalgamation" would suggest the merger of such funds, and "winding-up" would, in our view, generally imply termination of a fund. Whether such a winding up would necessarily include a discharge of liabilities is not clear from the context. We would suggest, for the reasons given above that there would have been no need to specify that a discharge of liabilities would necessarily follow on the exercise of the power, given that, again, from the member's point of view, the benefits are guaranteed.

Notwithstanding this uncertainty, the specific enabling power in paragraph 2 of Schedule 3 is also very broad, particularly in the phrase "or other dealing with" which would imply any other action the Secretary of State may wish to take, subject to the general principles that statutory functions and discretions can only be exercised within the judicial test colloquially known as "Wednesbury reasonableness", established in Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948]. In that case the judge held that "*if a decision on a competent matter is so unreasonable that no reasonable authority could ever have come to it, then the courts can interfere.*"

- (b) Paragraph 3 of Schedule 3 specifies provisions relating to the transfer of benefits:

"Regulations may [provide] for the payment and receipt of transfer values or in lieu thereof for the transfer or receipt of any fund or part of a fund or policy of insurance".

We understand the reference to the payment of transfer values here to apply to individual members although there is nothing to prevent that power applying on a bulk basis. Both assets and liabilities can therefore be transferred under this power, but, when read in conjunction with the powers above, it does not seem to add anything that is not already covered.

- 4.9 Finally, Schedule 3 also contains a general provision (under paragraph 13) to allow the Secretary of State to make "such incidental, supplementary, consequential and transitional provisions as appear to the Secretary of State to be necessary or expedient". However, this would be restricted by the scope of the original powers under the 1972 Act. As established by similar wording in s.111 of the Local Government Act 1972 (which has been the subject of detailed judicial authority in a line of cases on vires issues), a public body can only exercise powers that are within the framework of being incidental etc to the original power and not for some completely different purpose.

Conclusion

- 4.10 From the analysis above, we believe that there is a clear statutory power to amalgamate funds (i.e. assets only). We do not believe there is such a clear power to transfer liabilities without looking at the way that those liabilities attach to AAs and/or scheme employers, as to which see below.

Future regime (post 2013 Act)

- 4.11 We now need to examine the different ways in which the 2013 Act and the 2013 Regulations deal with these powers.
- 4.12 Section 1 of the 2013 Act provides a power to make "scheme regulations" to establish schemes for payment of pensions and other benefits for local government workers.
- 4.13 It is interesting to note the use of the word "scheme" and the word "fund" in the 2013 Act, a complexity that is not present in the 1972 Act (which uses the word "fund" throughout).

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"Scheme" is defined in the 2013 Act as meaning "*includes arrangements of any description*". In context, therefore, this would not necessarily be limited to new pension schemes (which would be "new public body pension schemes" covered by section 30). It is clear elsewhere that such an arrangement can be connected with another scheme (see section 4(6)). The term "scheme" is widely used in the 2013 Act. In general it can be taken as referring to the new benefit structures established under existing public sector pension arrangements.

It appears that the 2013 Act uses the word "fund" (although it is not defined) to refer to the assets supporting the "scheme".

- 4.14 From 31 March 2014 no further benefits can be provided under the existing regulations relating to the LGPS made under the 1972 Act except where the benefits can also be provided under the provisions of the 2013 Act (Section 18). However, to that extent, existing LGPS funds are treated as if they had been established under the 2013 Act (see Section 28(3)). In essence, Section 28 creates a bridging power to link pre 2014 and post 2014 LGPS benefits. However we note that section 28(2) preserves regulations made under section 7 of the 1972 Act:

"to the extent that:

- (a) *such regulations make provision for the payment of pensions and other benefits [for post 1 April 2014 Service], and*
- (b) *that provision could be made under scheme regulations."* [emphasis added].

- 4.15 This power is restricted in its scope to regulations which are for the purpose of "payment of pensions and other benefits", which would not encompass a power to amalgamate funds nor alter the Investment Regulations.

- 4.16 Section 3 provides for a broad power for regulations to be made by the Secretary of State (as the "responsible authority" under Schedule 2) in relation to schemes under the 2013 Act:

"3 Scheme regulations

- (1) *Scheme regulations may, subject to this Act, make such provision in relation to a scheme under section 1 as the responsible authority considers appropriate.*
- (2) *That includes in particular-*
 - (a) *provision as to any of the matters specified in Schedule 3;*
 - (b) *consequential, supplementary, incidental or transitional provision in relation to the scheme or any provision of this Act.*
- (3) *Scheme regulations may-*
 - (a) *make different provision for different purposes or cases (including different provision for different descriptions of persons);*
 - (b) *make retrospective provision (but see section 23);*
 - (c) *allow any person to exercise a discretion.*
- (4) *The consequential provision referred to in subsection (2)(b) includes consequential provision amending any primary legislation passed before or in the same session as this Act (as well as consequential provision amending any secondary legislation).*
- (5) *Scheme regulations require the consent of the Treasury before being made, unless one of the following exceptions applies.*
- (6) *The exceptions are-*
 - (a) *scheme regulations of the Scottish Ministers relating to local government workers, fire and rescue workers and members of a police force;*
 - (b) *scheme regulations of the Welsh Ministers relating to fire and rescue workers."*

- 4.17 On the face of it, this gives the Secretary of State very broad powers to legislate for anything connected to the LGPS, albeit subject to the 2013 Act. The general rules discussed in section 4.8 above about the reasonableness of the Secretary of State's decision-making powers would therefore also apply. The

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Explanatory Notes to the Act give examples of what is meant by the limits prescribed by the phrase "subject to this Act", eg the scheme manager provisions in section 4.

4.18 Construing the rest of the language in Section 3 of Schedule 2 and the scope of the Secretary of State's powers is complex because of the following factors.

- (a) The list of matters in Schedule 3, in Section 3(2)(a) which, as noted above, includes no reference to merger or amalgamation, is prefaced by the non-exhaustive words "in particular". The Explanatory Notes (para 20) reinforce this point: "If a matter is not mentioned in Schedule 3 this does not prevent it from forming part of such a scheme, provided it is within the powers given by sections 1(1) and 3(1)". (emphasis added albeit this is merely a note, not the statute itself) .
- (b) The terminology in sub-Section 3(3) is also clearly very broad. The Explanatory Notes (para 22) are less helpful here: "This is a common provision in regulation-making powers to ensure that they are appropriately flexible." Of itself, however, the "purposes" or "cases" must still be referable to the scheme as envisaged by section 1.
- (c) Finally, para 24 comments on the references to the "consequential provision" in Section 3(4): "only primary legislation passed before or in the same parliamentary session¹⁰ as this Act can be amended. This power may be necessary where legislation is inconsistent with or requires modification as a consequence of scheme regulations or a provision of this Act. Section 24(1)(a) further requires that any amendment to primary legislation must be made by the affirmative procedure. The meaning of "affirmative procedure" is given in section 38(2)", which essentially says that any regulations have to be laid before both Houses of Parliament and approved by both Houses.

4.19 Taking all of these points together, there is a multiple test to establish whether "scheme regulations" can or cannot be made within the ambit of Section 3:

- (a) they must be "appropriate" for the Secretary of State, acting reasonably, to make in relation to the LGPS;
- (b) the list of matters in Schedule 3 is non-exhaustive and scheme regulations may be made for "different purposes or cases", but again must in some way attach to the LGPS as a scheme; and
- (c) if a consequential provision is encapsulated within a regulation made under Section 3, it can only be passed by the affirmative resolution procedure, i.e. by both Houses of Parliament.

4.20 Applying these principles to the Act as drafted, the following conclusions can be reached. Section 3(2)(a) provides that regulations may be made in relation to the matters set out in Schedule 3. The provisions relevant to a transfer of benefits and the potential merger of funds are as follows.

- (a) *"The payment or receipt of transfer values or other lump sum payments for the purpose of creating or restoring rights to benefits (under the scheme or otherwise)"* (paragraph 10 – emphasis added).
- (b) *"Pension funds (for schemes that have them). This includes the administration, management and winding-up of any pension funds"* (paragraph 11 – emphasis added).

¹⁰

This is an annual period running from the first Thursday of May, the 2013 Act received Royal Assent on 25 April 2013 so the relevant session has now apparently passed.

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- 4.21 There is therefore no equivalent specific power under the 2013 Act allowing regulations to be made for the "amalgamation" of pension funds as under paragraph 2 of Schedule 3 of the 1972 Act. Notwithstanding this lack of a reference, we need to confirm whether the very broad power under Section 3 is sufficient to allow for amalgamation of funds, given the hurdles set out above. It is certainly odd that the wording was not carried over from the 1972 Act.
- 4.22 A contrary argument to the lack of an express reference to the power to amalgamate funds can be found in the wording of paragraph 11 to Schedule 3 of the 2013 Act. That paragraph, as quoted above, includes the words "*This includes*". Applying a general principle of construction, this would suggest that the activities which can be made the subject of regulations under Schedule 3 paragraph 11 is not exclusive and it might be argued that the amalgamation and merger of pension funds is necessarily to be implied in the phrase "*administration, management and winding-up*". We would recommend seeking Counsel's opinion on this argument.
- 4.23 We now need to consider whether the power to make regulations governing LGPS Funds themselves and the appointment of AAs could be used to transfer both the assets and the liabilities on an amalgamation (if that power could be exercised under regulations made under section 3(1)). Clearly, the assets of a particular LGPS Fund, on a merger or amalgamation, would then become assets of the new merged entity.

5 POWER TO SUBSTITUTE ADMINISTERING AUTHORITIES

- 5.1 The provisions relevant to the admission of "participants" (i.e. employers) into the LGPS are currently found in part 4 of the 2008 Regulations. There are two broad groups of participants (termed "employing authorities") whose employees may join the LGPS: Scheme Employers and Admission Bodies.
- 5.2 In each case the 2008 Regulations dictate the "appropriate fund" that the employees of each employing authority will be eligible to join (see below). The 2013 Regulations provide for a similar mechanism at Part 2 of Schedule 3.
- 5.3 Schedule 4, part 1 of the 2008 Regulations sets out a table of appropriate authorities. However, broadly:
- (a) employees of an AA are members of the fund maintained by that authority;
 - (b) employees of an admission body are members of the AA's fund with which the admission body entered into an admission agreement; and
 - (c) where an authority does not have its own fund, the 2008 Regulations refer back to the Local Government Pension Scheme Regulations 1997 which, at Part 3 of Schedule 5, contains a list of authorities participating in other funds.
- 5.4 Schedule 2 of the 2013 Regulations contains the corresponding list of AAs to the 2008 Regulations. In order to sever the linkage between scheme employers and the appropriate AA that would necessarily happen on a merger, it would be necessary to amend these provisions to allocate an alternative fund to each scheme employer. Such an amendment could be made by "consequential" regulations under section 3(2)(b), which, as noted above, brings into play the affirmative procedure.
- 5.5 Schedule 4 of the 2008 Regulations further states that where an employing authority "merges or amalgamates" with another employing authority, or the members would be required to contribute to more than one fund, then the employing authority can make an application to the Secretary of State to direct to substitute the fund to which its employees are allocated. Note that it is the employing authority which must merge or amalgamate, not the fund itself, to trigger such a reorganisation.

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Before making such a direction, the Secretary of State must consult with any affected bodies, but ultimately may:

"...require the making of financial adjustments between the funds, whether by way of payment to the substituted fund or a transfer of assets or both.

It may also contain provision as to the transfer of liabilities to the substituted fund, may require a revised rates and adjustment certificate in respect of each employing authority concerned, to take account of the effect of the direction and may make provision for any other consequential or incidental matters."

- 5.6 Consequently, since an "employing authority" is defined as "a body employing an employee who is eligible to be a member" any scheme employer or admitted body can make an application to the Secretary of State for a direction to substitute the fund in relation to its participation in the LGPS.
- 5.7 The power is dependent on each AA making an appropriate application and is not within the gift of the Secretary of State. Further, although these legislative provisions apply directly to substitute any fund applicable to a scheme employer or admission body, there is no specific provision for an automatic substitution of AA for the purposes of an admission agreement. Consequently, the admission body would have to enter into a new admission agreement with the new relevant AA on each substitution of fund.
- 5.8 Schedule 3 of the 2013 Regulations contain comparable but not precisely the same powers in relation to transfers. The relevant powers of the Secretary of State have been simplified in the language but again operate on application by the scheme employer, not as a reserved power:

"3 *The Secretary of State may, on application by a Scheme employer, by a written direction substitute a different administering authority as the appropriate administering authority for a person or class of person.*

4 *A direction under paragraph 3-*

- (a) *may only be given after the Secretary of State has consulted any bodies appearing to be affected by a proposed direction, and*
- (b) *may include provision as to the making of adjustments between funds, the transfer of assets and liabilities, and any other consequential or incidental matters."*

Note that, in order for these powers to be used, the Secretary of State must consult with the "bodies" affected by the proposed transfer.

Further on in Schedule 3, under paragraph 12, there is scope for regulations to be made in relation to:

"The administration and management of the scheme, including –

- (a) *the giving of guidance or directions by the responsible authority to the scheme manager (where those persons are different);*
- (b) *the person by whom benefits under the scheme are to be provided;*
- (c) *the provision or publication of the information about the Scheme."* (Emphasis added)

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From the above, it will be seen that paragraph 12(b) does allow the Secretary of State to make regulations in relation to changing an AA, given that that is the "*person by whom benefits...are to be provided*".

Transfer of statutory functions of current AAs to new bodies

- 5.9 In order to implement and administer a merger of funds successfully it would be necessary to transfer certain powers, including the administration and investment powers, from the current AAs to new AAs or to create one or more separate bodies to exercise those powers. In the past, this has always been done by primary legislation (see Section 7 below). No doubt that was because other non-pension powers were being transferred also.

It may be, if the conclusion is reached that the powers in Section 3 and Schedule 3 are broad enough, secondary legislation could be provided to achieve the same result.

- 5.10 Whichever route might be adopted, care would need to be taken if any transfers of funds and liabilities were to be made, in light of the South Tyneside¹¹ case.
- 5.11 In the South Tyneside case certain committees of five magistrates' courts were abolished and the liabilities transferred to a new body, after certain court reforms, the Lord Chancellor became successor to those liabilities. Despite the transfer, the Lord Chancellor refused to fund a deficit relating to former employees of the abolished magistrate's court committees. The Court of Appeal found that, on proper construction of the LGPS regulations then in force, there was no obligation on the Lord Chancellor to contribute to the fund in question as the employing authority's employees no longer made contributions to that fund.
- 5.12 This raises, in particular, the issue that making any transfers without clear legislative authority could have unintended consequences and that, on a transfer, contributions (including deficit payments) from "former" employers that are owed to the current AAs should be addressed before rather than after the event.

6 WHAT ARE THE POWERS TO TRANSFER ADMISSION AGREEMENTS AND/OR SUPPLY CONTRACTS?

- 6.1 One of the potential consequences of Option 3 would be the lack of a contractual relationship between the scheme employers and the relevant new AA that would assume responsibility for administering the merged fund. Existing contractual relationships are evidenced by an admission agreement. The terms of admission agreements are prescribed only as to their minimum content by regulations (Schedule 3 to the 2008 Regulations and Part 3 of Schedule 2 to the 2013 Regulations). These include certain automatic termination events, which are as follows:
- (a) if the admission body ceases to be such a body (note that, under paragraph 8 of Schedule 3 of the 2008 Regulations, admission bodies must notify the AA of anything which may be a termination event. This includes a take-over, reconstruction or amalgamation of the employer, liquidation or receivership or a change in the nature of the body's business or constitution).
 - (b) on three months' notice (paragraph 9 to Schedule 3); and
 - (c) the parties to the admission agreement may also make such other provision about its termination as they consider appropriate.

¹¹ **South Tyneside Metropolitan Borough Council, R (on the application of) v The Lord Chancellor and Secretary of State for Justice & Anor EWCA Civ 299**

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7.2 Abolition of the Greater London Council (GLC).

- (a) The Local Government Act 1985 (LGA 1985) provided for the abolition of both the GLC and the Metropolitan County Councils, with effect from 1 April 1986. A number of the functions of the GLC were transferred to the London Residuary Body set up for that purpose.
- (b) Section 60 of the LGA 1985 provided for the automatic transfer of the GLC's position as an AA to the London Residuary Body. This included, specifically:
 - (i) functions as an AA under Regulations made under Section 7 of the 1972 Act; and
 - (ii) all liabilities of the GLC in respect of pensions payable by it or otherwise.
- (c) These functions and liabilities were then transferred to the LPFA on the winding up of the London Residuary Body at the end of October 1989.
- (d) Since the GLC had a number of statutory functions other than acting as an AA, and Government was also abolishing other Metropolitan County Councils, it is not unexpected to find that Government chose to use primary legislation Act to transfer the AA functions of the GLC.

7.3 Local Government Reorganisation in Wales

- (a) The Local Government (Wales) Act 1994 (the 1994 Act) contains, at Section 17, a general provision to transfer the functions of the councils being abolished. It has the effect of amending all legislation that referred to the previous council so that it instead refers to the new principal area (post re-organisation).
- (b) The Act does not, however, deal with the specifics of the transfer of LGPS functions. This was enacted by the Local Government Pension Scheme (Local Government Reorganisation in Wales) Regulations 1995, which were made under section 7 of the 1972 Act (and not under the 1994 Act).
- (c) These Regulations provide for the wholesale transfer of each previous council's functions and obligations as an AA to the successor authority.
 - (i) Transfer of functions as AA, along with rights and liabilities:

"all the functions of a previous fund authority as AA under the principal Regulations then in force shall become functions of the successor authority and the pension fund maintained by the previous fund authority, together with all rights and liabilities in respect of it, shall on that date vest in the successor authority."
 - (ii) Employing authorities and admission bodies' obligations to contribute to that fund are moved:

"any liability of any body or person to make payments into a pension fund maintained immediately before 1st April 1996 by a previous fund authority shall become a liability to make payments into the pension fund maintained by the successor authority"
 - (iii) Contracts in place for the purposes of the pension fund were novated:

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"All contracts, deeds, bonds, agreements and other instruments subsisting in favour of, or against, and all notices in force which were given by or to a previous fund authority (or any other body on their behalf) for the purposes of the pension fund maintained by them shall after 31st March 1996 be of force [sic] in favour of, or against, the successor authority"

(iv) Admission agreements:

"Without prejudice to the generality of paragraph (3), any admission agreement in force immediately before 1st April 1996 between a body and a previous fund authority whereby employees of that body were, or could be, admitted to participate in the benefits of a pension fund shall after 31st March 1996, have effect as an agreement under regulation B7 of the principal Regulations between the body and the successor authority".

(v) The obligation to contribute in respect of previous employees was also moved to the successor authority:

"Where a person-

(a) has ceased to contribute to a pension fund before 1st April 1996; and

(b) has not become a contributor to any other fund maintained under the principal Regulations

the pension fund maintained by the successor authority for the previous fund authority who maintained that fund until 31st March 1996 shall after that date be deemed to be the fund to which he was last a contributor."

7.4 South Yorkshire Pensions Authority

The Residuary Body

(a) The Local Government Reorganisation (Pensions etc) (South Yorkshire) Order 1987 (the "SY Order") was made under powers in section 67(1)(a) of the LGA 1985:

"The Secretary of State may by order provide for any such transfer or disposal as is mentioned in subsection (1) or (2) above, whether as proposed by the residuary body or otherwise, and for giving effect (with or without modifications) to any scheme submitted to him under subsection (1) above; and, without prejudice to the generality of that power, any such order may contain such supplementary and transitional provisions as the Secretary of State thinks necessary or expedient, including provisions amending any enactment or any instrument made under any enactment or establishing new bodies corporate to receive any functions, property, rights or liabilities transferred by the order."

(b) The above power is a general one for the Secretary of State to make orders to implement an arrangement for the wind up of residuary bodies, and transfer of powers to the new authority (this arrangement is referred to in the power as a "*transfer or disposal as is mentioned in subsection (1) or (2) above*"). The residuary body in question was created by the LGA 1985 as a result of the abolition of the Metropolitan County Councils ("MCCs").

(c) These powers are clearly specific to the circumstances provided for by the LGA 1985 (i.e. the abolition of the GLC and the MCCs), which depend on there being a "residuary body" and the

removal or abolition of the powers of that body. However, it provides a precedent for a broad provision in primary legislation to be used to transfer pensions rights and obligations.

- (d) As an aside, the Residuary Body was not given fund raising powers in its own right; it was granted the power by Section 74 of the LGA 1985 to make levies on the rating authorities in its areas to "*meet all liabilities falling to be discharged by it*".

Transfer of pension functions

- (e) The SY Order established the South Yorkshire Pension Authority as a body corporate specifically to receive "*functions, property, rights and liabilities transferred by this Order*". The SY Order then went on to make the transfer of all the obligations and liabilities of the residual body in relation to pensions (as specified in Schedule 2):
- "(a) *the functions of the Residuary Body as [AA] under the Local Government Superannuation Regulations 1986, together with the superannuation fund maintained by the Residuary Body and all property, rights and liabilities in respect of it;*
- (b) *the functions, rights and liabilities of the Residuary Body in respect of pensions payable by it otherwise than under those Regulations;*
- (c) *without prejudice to the foregoing, the functions, rights and liabilities which are vested in or fall to be discharged by the Residuary Body under or by virtue of section 61 of the 1985 Act (payment of pensions increases); and*
- (d) *any moneys or other property forming a fund maintained by the Residuary Body for the purposes of the functions referred to in sub-paragraphs (b) or (c)."*
- (f) The SY Order also made provision for the funding of the South Yorkshire Pension Authority. Article 4 provides:

"The net expenditure of the Authority in any financial year shall be apportioned between the district councils in the county of South Yorkshire in proportion to the population of their districts, as that population is certified for the making of levies with respect to that year under section 74(2) of the 1985 Act (levies by residuary bodies); and the appropriate portions shall be recoverable by the Authority from each of those councils on written demand."

8 HOW WOULD THE PROPOSAL AFFECT PUBLIC SCHEMES OTHER THAN THE LGPS?

- 8.1 The proposal to include non-LGPS schemes in any of the three Options under consideration raises completely different and, in our opinion, insuperable problems which cannot be addressed simply by legislative means (whether primary or secondary). The problems relate to the fact that the trustees of each of the schemes under consideration are bound by the powers that are given to them under their respective trust instruments and also by private sector pensions legislation which reserves to those trustees the following key powers, which can only be exercised unilaterally:

- (a) the power of investment ; and
- (b) the power to transfer assets to another registered pension scheme.

We have not considered any of the trust deeds and rules of the schemes listed in the schedule provided by DCLG and therefore the following analysis draws on general points of principle.



TALENT • HEALTH • RETIREMENT • INVESTMENTS

LGPS STRUCTURAL REFORM CONSULTATION AND COLLABORATIVE INVESTING

2 JUNE 2014



WELCOME & OUR APPROACH TO THE CONSULTATION

Jo Holden

AGENDA

Mercer approach to consultation

A perspective from Railpen

CIV structures

Mercer approach to multi investor frameworks

Active passive

Fund of funds

Collaborative procurement - custody

£200bn

Assets

£50bn

Deficit

£660m

Savings
required

A bigger question

“What’s the risk of not getting
a handle on deficits?”

Play the game?



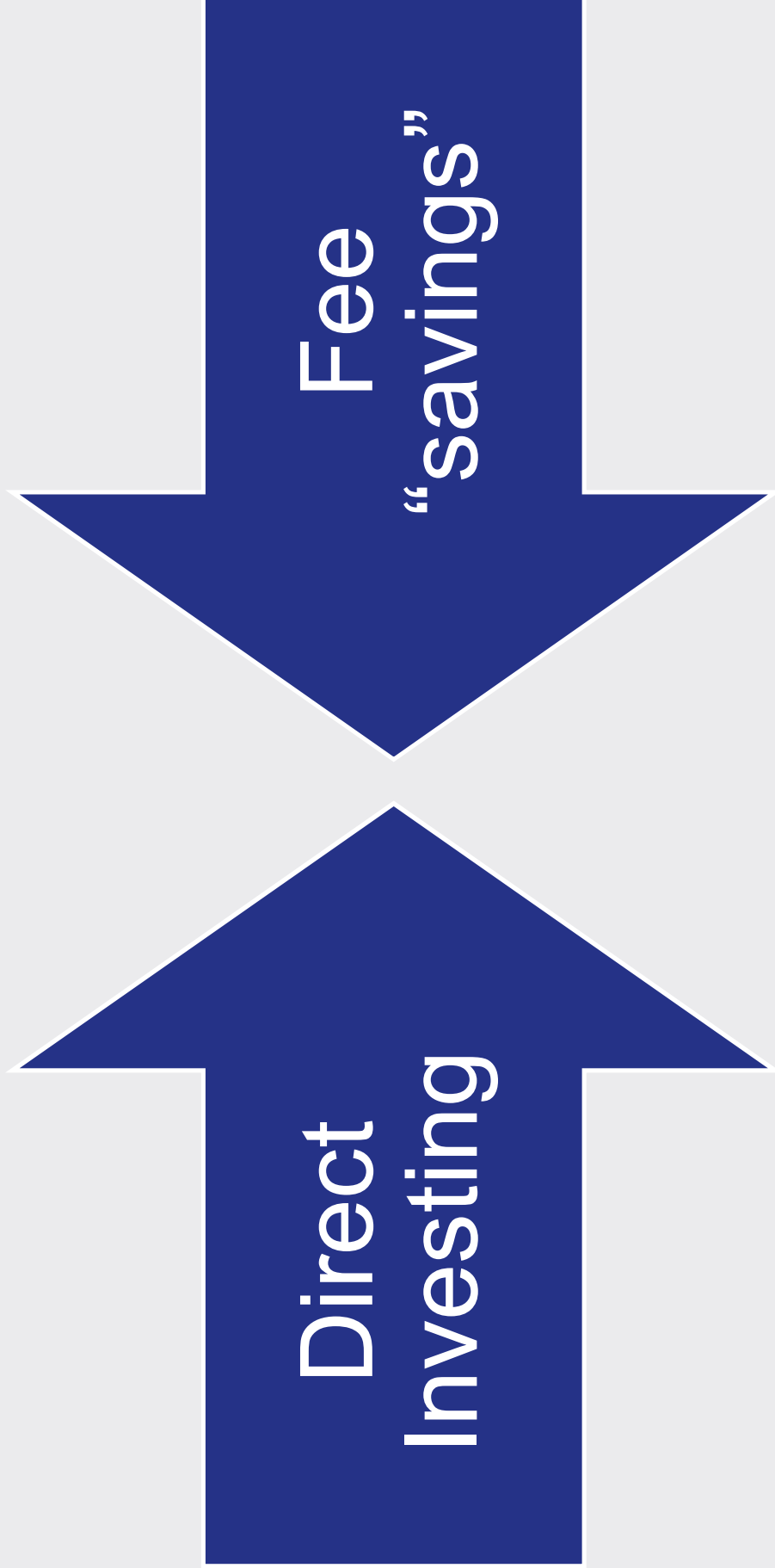
Reasons behind success stories

Thoughts on “failures”

Why not wholesale passive?

Hidden risks?

Hidden costs?

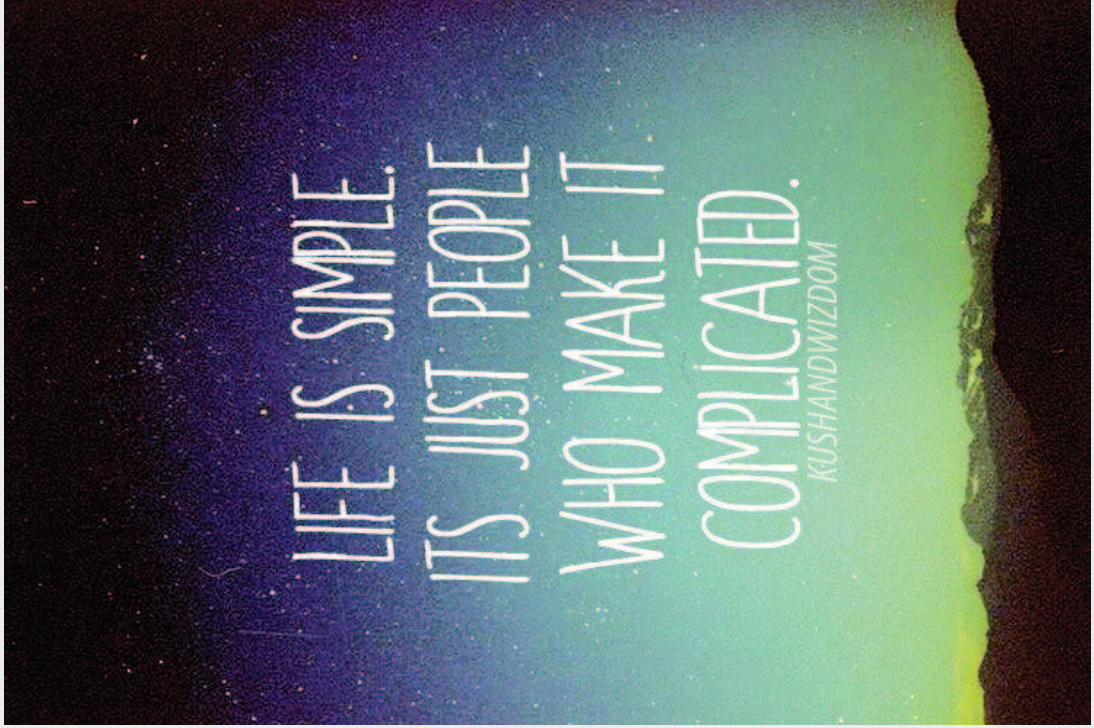


Private Sector Case Study

Unilever

- Circumstances:
 - 80 funded pension plans
 - c€20billion in assets
- Established pooled funds to capitalise on combined scale and improve governance
- Originally established 11 funds; c€6.5bn of assets in the pooled funds
- The set up process:
 - Time
 - Leadership
 - Comfort
 - Providers
- Costs
 - Set up
 - On-going
 - No “disappearing act”
- Ongoing
 - Currently rationalising number of funds to 8
 - Changing operational structure of pooled funds.
 - Adhering to changing regulatory requirements

Alternatives to CIVs



Have all the risks and costs been considered?



COLLECTIVE INVESTING AT RAILPEN

Craig Heron, RPMI

ASSET CONSOLIDATION / CIV STRUCTURES

Amit Popat

Asset Owners – Common Objectives

1. Reducing Costs & Leveraging Scale
2. Streamlining Governance & Decision-making
3. Decision-making v Implementation
4. Oversight & Reporting
5. Future Proofing & Change Management

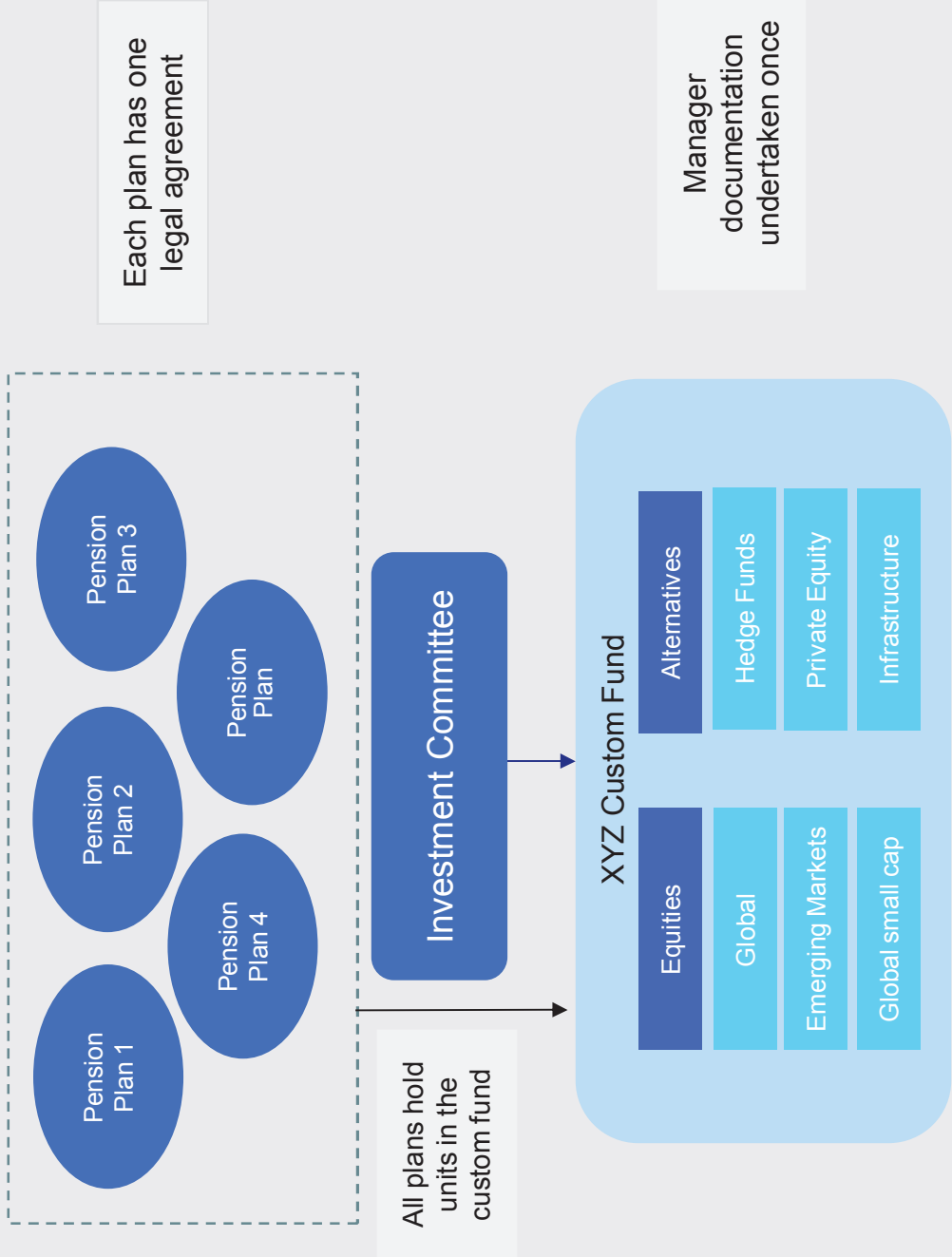
The above themes are driving Asset Owners to develop tailored governance frameworks to improve governance, enhance risk management, lower cost and implement better operational management

Key decision parameters for implementation vehicles

- Regulated environment and entity
- Recognised operating model
- Future proofing
- Flexibility of incorporating investment strategies
- Cost efficiency / savings

Overview of operating model

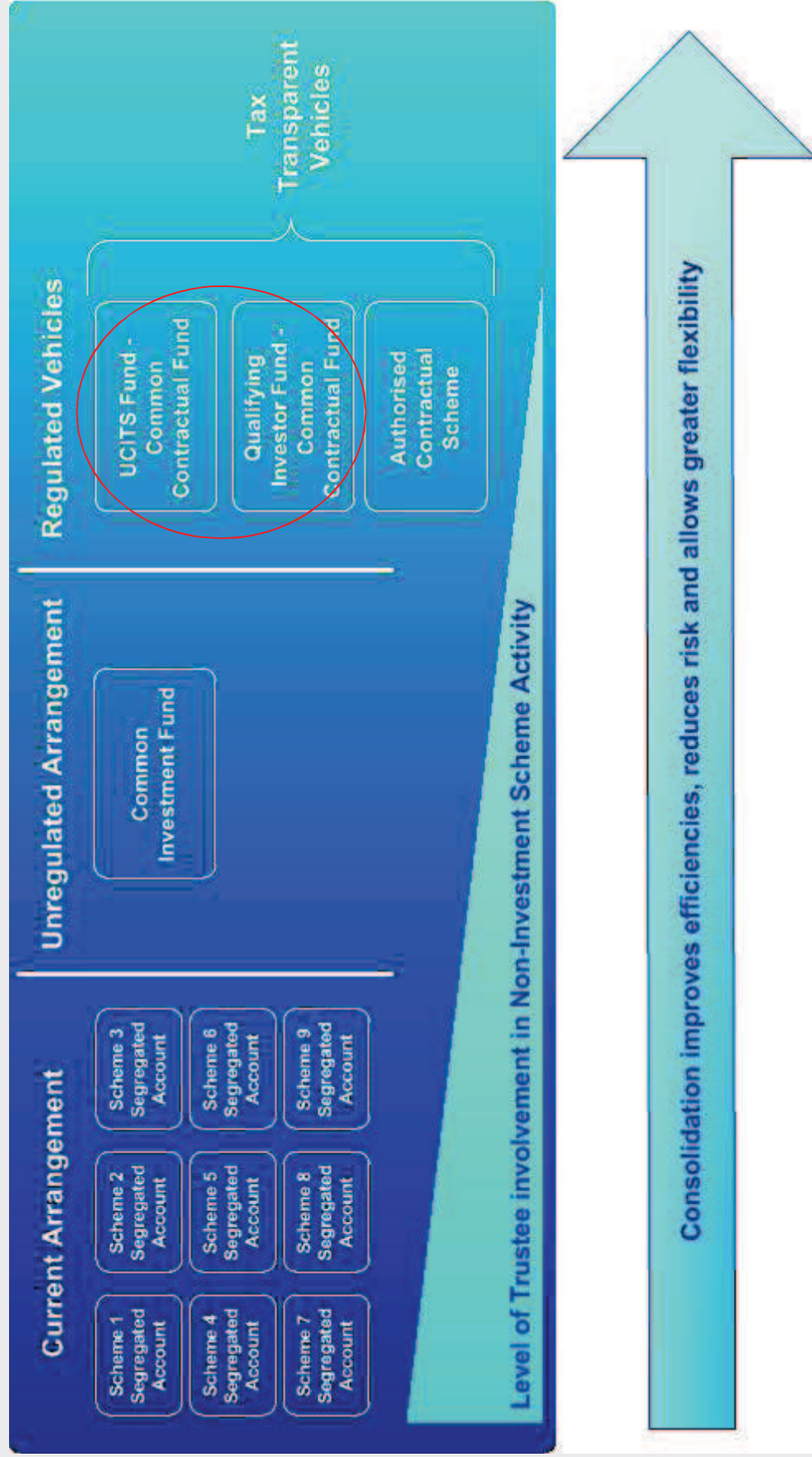
A case study



Service benefits

- Specific fund established for multiple pension plans
- Investment Committee decides on managers and fund structures
- Oversight and operational activities delegated
- Segregated manager accounts for transparency and risk management
- Structure facilitates continuous risk and return execution of manager changes, re-balancing in association with XYZ
- Potential manager fee & tax savings
- Improved governance, manager, operational and cost efficiencies
- Increased flexibility to adopt future changes.

Asset Consolidation Continuum of Options: Potential Structures Available



What is a CCF?

- The Common Contractual Fund (“CCF”) is an investment vehicle introduced in Ireland in 2003 to enable institutional investors, including pension funds, to pool investments in a tax efficient manner.
- It is an open-ended umbrella authorised pursuant to the Investment Funds, Companies and Miscellaneous Provisions Act 2005 by the Central Bank
- Over 70 funds have been established since 2003
- CCF’s can be set up as Qualifying Investment Funds (QIF) i.e. Non-UCITS or as UCITS Funds
- QIF’s are subject to a less restrictive regulatory regime than UCITS and afford greater flexibility in terms of less investment restrictions
- QIF’s do not take as long to set up as UCITS funds
- QIF’s legal expenses are typically less than UCITS due to the lighter regulatory requirements.

Regulated environment Domiciled in Ireland

- An internationally recognised fund domicile.
 - Ireland is an internationally recognised jurisdiction with membership of the EU, Eurozone, OECD, FATF and IOSCO.
 - For more than 20 years Ireland has been a leading regulated domicile for internationally distributed investment funds, dealing with the widest range of fund types from traditional 'long only' to more complex fund structures.
- A tax efficient domicile (including the option to utilise tax exempt fund vehicles). Key features include:
 - Irish investment funds are exempt from Irish tax on their income and gains, irrespective of where their investors are resident.
 - No withholding taxes apply on income distributions and redemption payments made by an Irish fund to non-Irish resident investors.
 - Ireland's extensive and growing network of double taxation treaties (currently almost 60) providing favourable tax reclaim rates.
 - The ability to structure Irish domiciled funds as tax transparent vehicles resulting in the retention of tax benefits (e.g. reduced withholding taxes) enjoyed by investors through direct ownership.
- A full range of legal and regulatory fund structures and regimes offering flexibility to meet clients' needs.
- A well developed fund and related professional services infrastructure that includes some of the largest and most experienced Fund Administrators, Custodians, specialist legal, tax and support services.
- A convenient time-zone for interaction with all major markets.
- A locally available and highly educated English speaking workforce of more than 12,000 professionals.

Operating and Costs efficiency

- The central rationale for establishing a CCF is the capacity to provide participants with a tax transparent vehicle, where participants should be treated as if they had invested directly in the assets acquired, but also benefit from all of the advantages of investing via a pooled arrangement including:
 - Reduced administration and accounting costs for consolidated assets.
 - Consistent investment management across a larger pool of assets
 - A greater level of oversight and control
 - An increased level of risk management
- CCF is treated as a tax transparent vehicle in over 20 markets including Australia, Canada, Germany, Italy, Switzerland and the US

Withholding Tax Cost Savings

WITHHOLDING TAX COST ("TAX DRAG")

(The withholding tax cost is illustrated as a percentage of the dividend yield of the MSCI World and MSCI Europe indices.)

PENSION INVESTORS	DIRECT INVESTMENT	CORPORATE UCITS	CCF UCITS	CCF BENEFIT
MSCI WORLD				
UK	0.06%	0.44%	0.06%	0.38%
NETHERLANDS	0.07%	0.44%	0.07%	0.37%
SWITZERLAND	0.08%	0.44%	0.05%	0.39%
MSCI EUROPE				
UK	0.14%	0.24%	0.06%	0.18%
NETHERLANDS	0.18%	0.24%	0.08%	0.16%
SWITZERLAND	0.30%	0.24%	0.09%	0.15%

Source: IFIA

Broader Considerations

- No VAT is applied to key services received by a CCF including investment management, administration*
- Irish CCF is no obliged to charge VAT on its services*
- There is no cross liability between sub-funds of an umbrella CCF

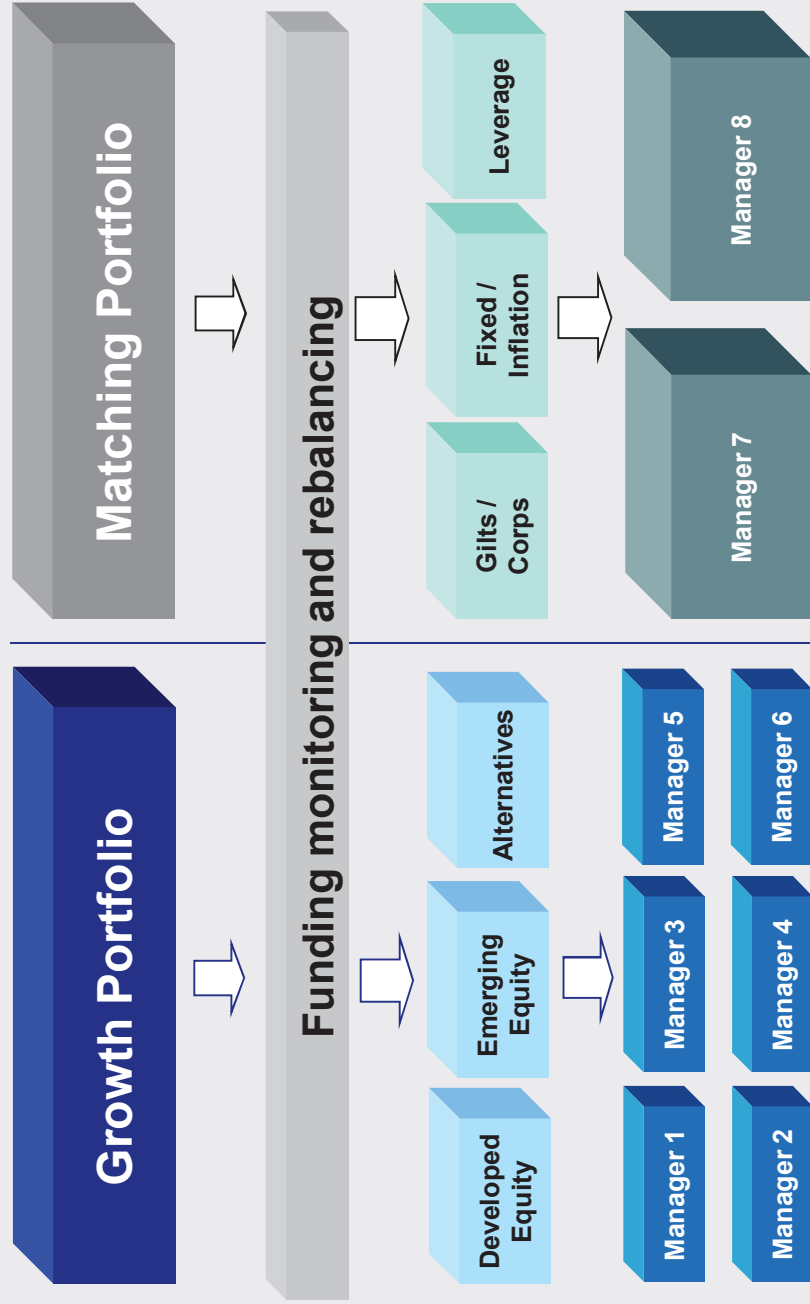
* This is subject to change and services outside the funds that are charged to the funds may be subject to VAT

MULTI-INVESTOR FRAMEWORKS – MERCER APPROACH

Dan Melley

Pension fund investments

Issues which need to be addressed



Case Study A

Multi national with several smaller country schemes

CANADA

- \$67,434,000 (0% segregated)
- Funds only, no custodian

IRELAND

- \$25,903,000 (0% segregated)
- Funds only, no custodian

SWEDEN

- \$245,465,000 (82% segregated)
- Assets held in 10 different custody arrangements

UNITED STATES

- \$358,124,000 (0% segregated)
- Bundled trustee and investment management with BNYMellon

UNITED KINGDOM

- \$549,052,000 (0% segregated)
- Funds only, no custodian
- No restrictions on moving providers

FINLAND

- \$360,492,000 (33% segregated)
- Seg assets held at multiple custodians
- No restrictions on moving providers

GENERAL OBSERVATIONS

- Total assets \$1,816,916,000
- 80% of assets are in pooled or insured arrangements c. \$349,174,000 are segregated
- C. 30 discrete investment managers with pooled funds

OTHER PLANS

- Austria: \$4,960,000 (10% segregated)
- France: \$6,717,000 (insured arrangement)
- Germany: \$118,384,000 (0% segregated)
- India: \$6,140,000 (0% segregated, 100% insured arrangement)
- Norway: \$18,471,000 (insured arrangement)
- Switzerland: \$16,629,000
- Japan \$34,640,000

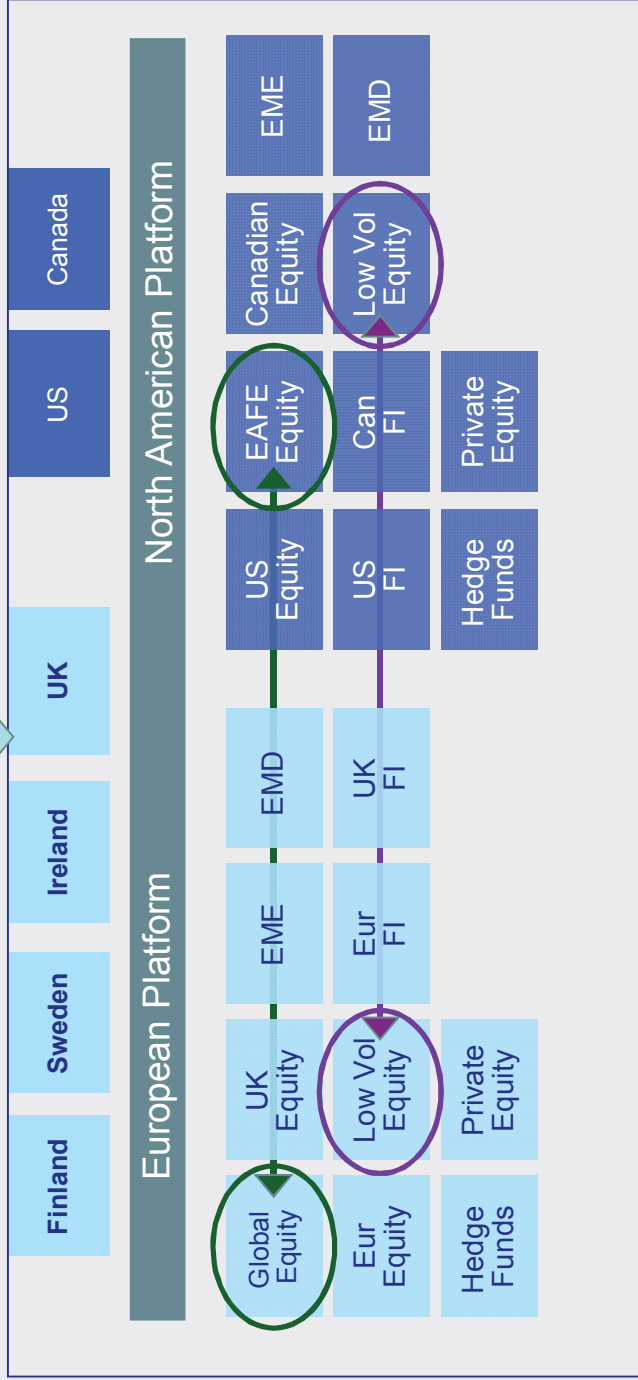
A European based Global Multi-National, with total Pension scheme asset base of \$2bn. The Corporate's key objectives were:

1. To improve and consolidate global oversight and reporting information. Significant cost and resources required by HQ to consolidate reporting internally. The process did not meet timely output. Recognition that that was only one of the governance challenges presented by existing arrangements.
2. Strong desire to leave strategic control to individual market Trustee/Investment Committees.
3. Strong desire to reduce cost

Case Study A – Leveraging existing scale

Corporate HQ

- Corporate sets Global investment policy & parameters
- Investment strategy and mandates designed & selected by Local market Committees
- Managers selected by Mercer, common managers across regions where sensible



Features

- A common global platform, supporting improved governance, oversight and reporting
- Empowerment of local Trustee / Investment Committees – providing greater focus on investment strategy, diversification and risk management
- Consistent manager program applied across all markets
- Efficient change management and speed of execution
- Highly cost efficient – annual fee savings in the region of c\$1.5m
- Overall, an enhanced global governance framework, particularly applicable to smaller markets (<\$500m pension assets)

Mercer Platform: State Street Global Custodian

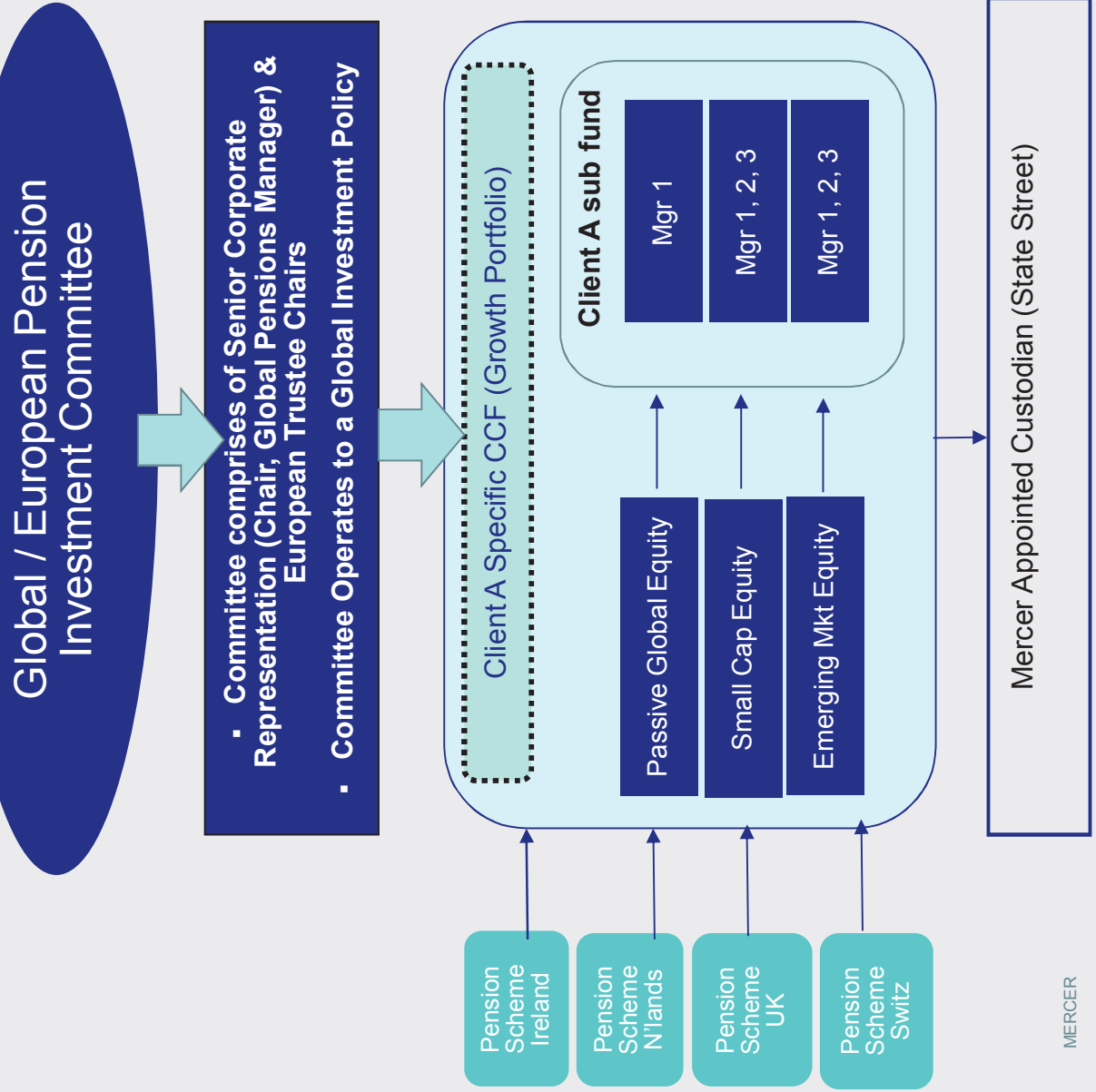
Case Study B - Overview



A Global Multi-National, with widespread European business operations and pensions schemes. They set up a single global investment committee but required an implementation framework to access wider governance benefits. Their key challenges:

1. Leveraging their internal expertise & implementing a single global investment policy, with consistent global mandates and managers. Strong desire to lead on all investment decisions.
2. Coordinating contrasting individual market decisions that simply increased cost and risk on the sponsor
3. Oversight and reporting - access to timely and accurate information
4. Cost reduction

Cross-Border Pension Scheme Investment Consolidation



Global / European Pension Investment Committee

- Committee comprises of Senior Corporate Representation (Chair, Global Pensions Manager) & European Trustee Chairs
- Committee Operates to a Global Investment Policy

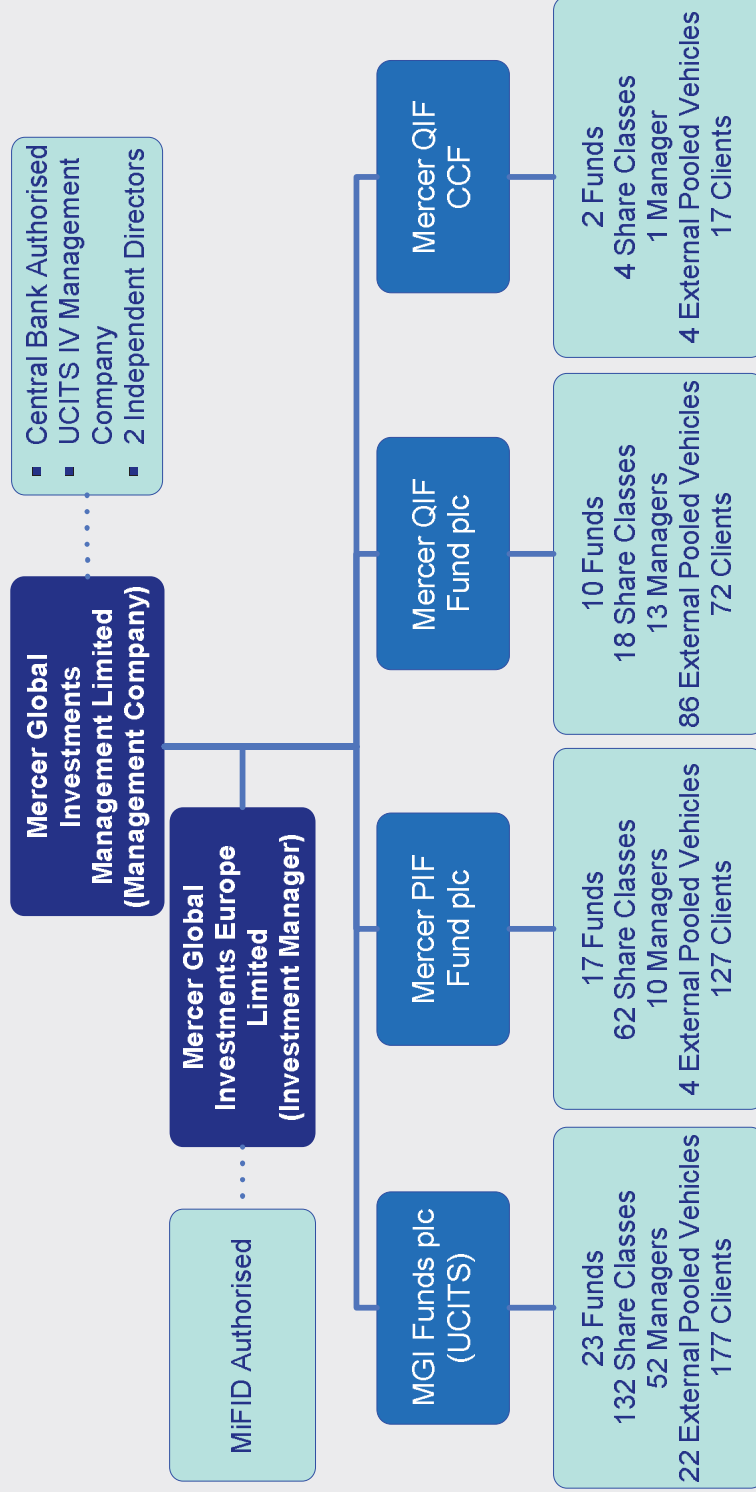
Features

- Mercer established a CCF for Client X, accessible by all Client X's European schemes
- Enhanced governance & decision-making through European Investment Committee linked to a single implementation framework to execute decisions in a timely and efficient manner
- Improved operational oversight and reporting across their investment arrangements, including enhanced oversight: Portfolio and manager level performance reporting including daily on-line access to fund valuation and security level data.
- Cost efficiency: lower manager fees (using Client X & Mercer global bulk buying power, tax efficiencies, lower ongoing transition costs, etc): Manager & tax savings in the region of \$1.5m p.a. for client
- Streamlined & increased speed of implementation / execution across all Plans.
- Increased flexibility to adopt future changes (including the potential to expand beyond core equities) consistently across all markets.

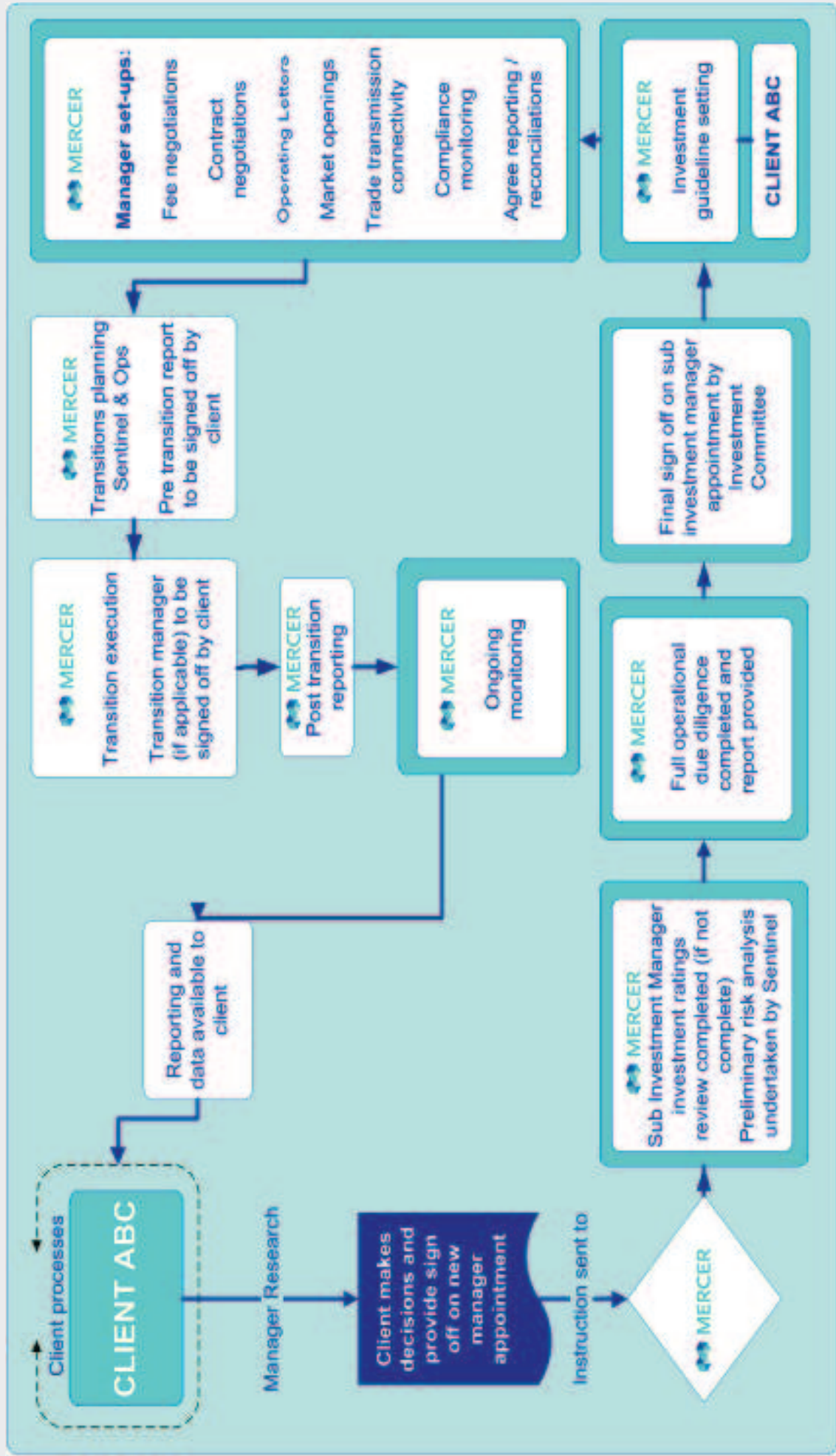
Overview of Mercer Fund Structure

Operational background

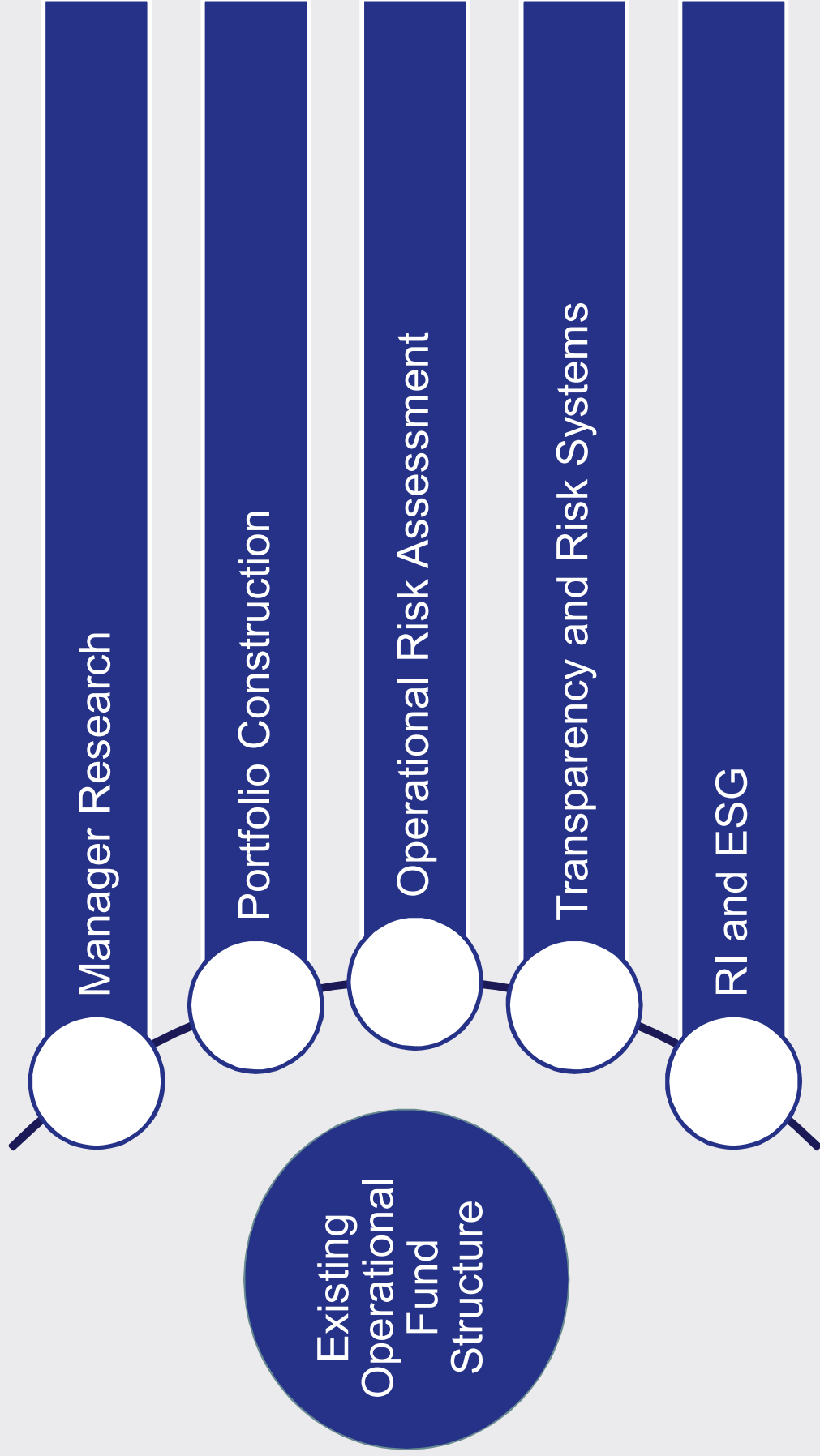
A tested and robust technical platform and infrastructure with 52 existing funds across differing legal and regulatory structures ensuring the delivery of tailored solution to meet the specific needs of the client – required regulatory regime, tax efficiencies etc.



Case Study Efficient Manager Change Process



Operational delivery and investment expertise



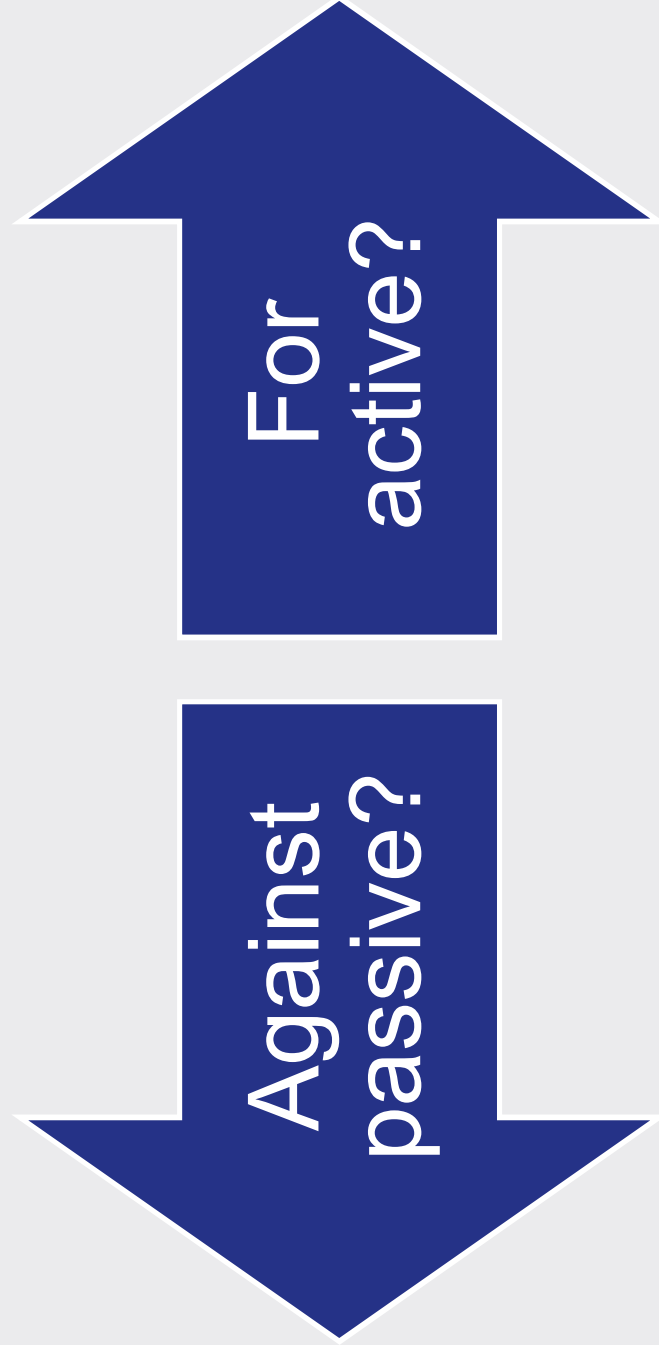
ACTIVE VERSUS PASSIVE

Andy Farrington

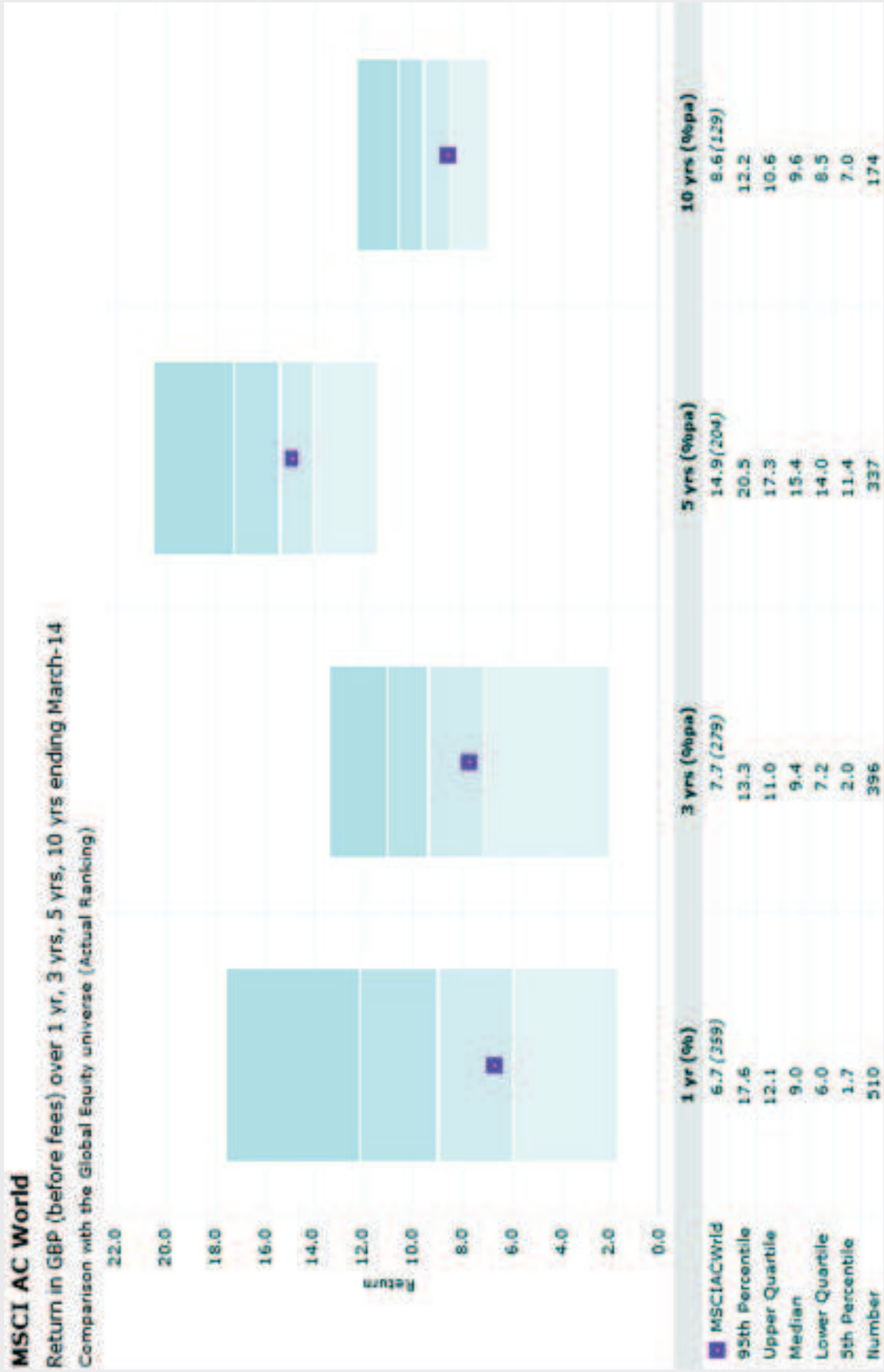
Health warning – only 5 minutes!



The consultation – active / passive



...Active management can work...



...and traditional passive investing is flawed...



...but is there a place for passive...?

Don't need to blindly follow the pack (market cap approach)



Other approaches available

Equal weighting

Fixed weighting

GDP weighting

Fundamental indexation

Diversification-based weighting

Risk weighting

Passive = responsible investing?

Will companies really take passive investors seriously – they know we are forced to hold the stock...?

Need to “hold” the stock in order for a Company to engage in the first place?



Summary

Pros	Cons
“Cheap”	Opportunity cost
Reliable (in a sense!)	Forces you to be “average”
Transactions (and therefore transaction costs) are lower – although c£40m reduction in revenue to HM Treasury!	Not low risk and a lack of control <ul style="list-style-type: none"> - Exposure whether you “like it or not” - Concentrations of risk - Not well diversified - Does not rebalance
Risk relative to the index is low	Remember where passive came from - performance measurement tool
“Safe” option for those Funds that have consistently underperformed?	Potential engagement issues



ALTERNATIVE INVESTING
Fund of Funds and the Consultation
Rob Howie

The benefits of alternative investments

Expanding the opportunity set

Alternatives play a range of roles

Are there any wider benefits?

Increasingly more mainstream

Increasingly a more professional industry



Successful investing in alternatives

Invest with the
best managers in
the world

Build robust
portfolios

Avoid cutting corners



Mistakes can be costly



You are likely to get what you pay
for



Take a holistic view of the
cost / benefit analysis

Done right, alternative investments can provide real benefits (after all costs)

The alternatives industry is barely “alternative” any more

But there is lots to choose from out there and it is of mixed quality

Back to the consultation

LGPS has £18bn in alternatives

Fees are 1.71% p.a.

Pool alternatives into CIVs?

Illiquid FoF would take up to 10 years to unwind

CIV would have its own “dedicated investment management team”

This would “save £1.1 billion over 10 years”

Also “the early closure of high fee alternatives”

Suggestion that £18b of alternative assets can be run at a total cost of 0.35% p.a. (including manager fees)



COST SAVINGS BY PROCURING CUSTODIAL SERVICES UNDER THE NATIONAL FRAMEWORK

Jessica Hynes

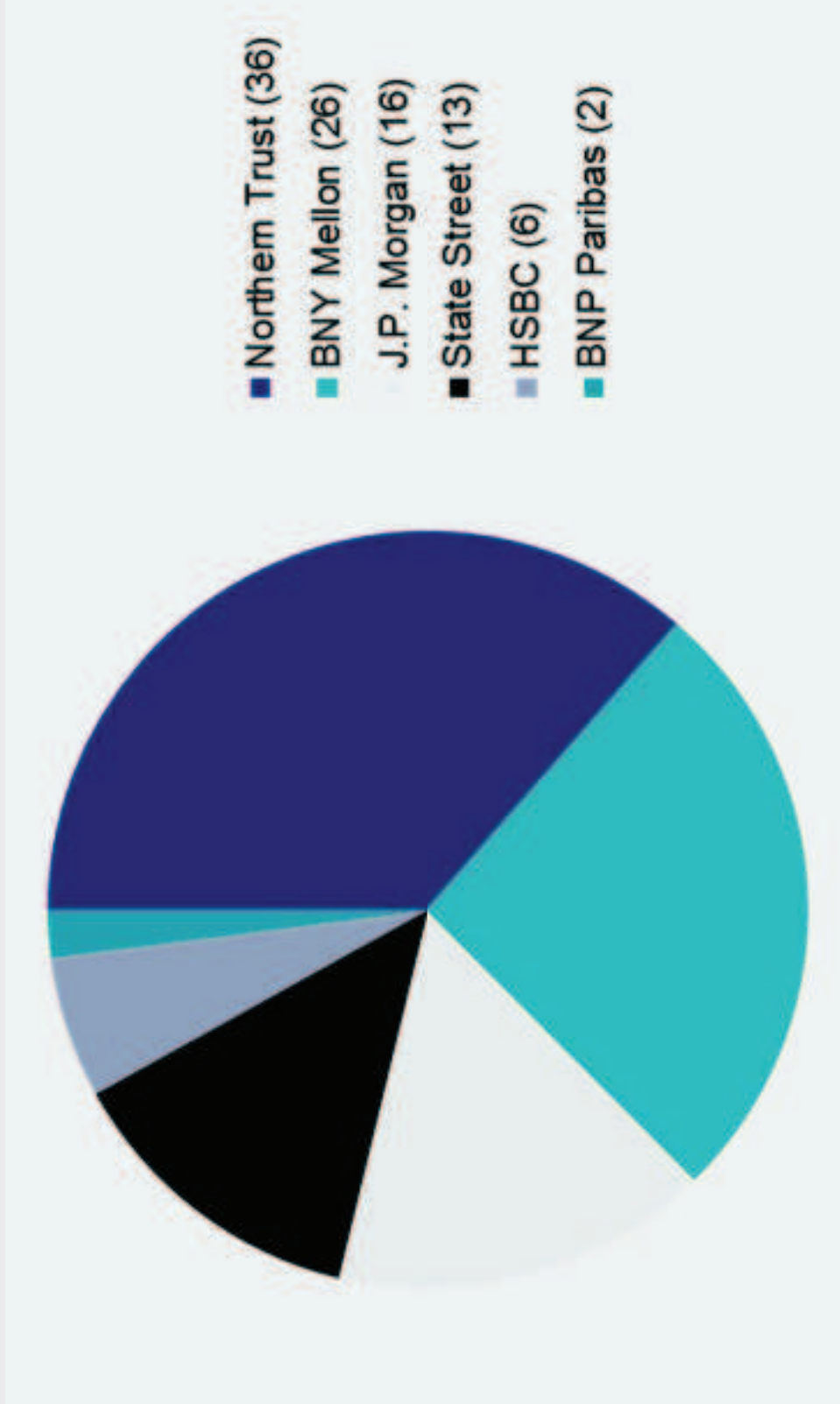
LGPS Collaboration Custodian Procurement Framework

- Collaboration is not just about investing together, but pooling assets to **increase buying power**
- Three LGPS Frameworks:
 1. Actuarial and Benefit Consultancy Services Framework - June 2012
 2. Investment Consultancy Services Framework - April 2013
 3. **Framework for Global Custody Services – November 2013**

The Framework provides LGPS funds with a pre-selected board of service providers that meet Official Journal of the European Union (OJEU) procurement requirements, which all public sector organisations are subject to.

- LGPS must formally re-procure at the end of their contracts, every 3 to 5 years
 - Common needs, limited choice of providers
 - Usually engage a consultant to manage the project
 - OJEU process is expensive and time-consuming

LGPS Custodian Framework Current LGPS Custodian Banks



LGPS Collaboration Custodian Procurement – Results so far

- Estimated **30 LGPS** are interested in procuring under the Framework
 - Larger or more complex Schemes may wish to procure independently
 - Smaller Schemes that are invested exclusively in pooled funds may not require a custodian
- **Completed**
 - Norfolk, Suffolk and London Borough of Hackney
 - Agreed to pool assets for joint procurement of 3 separate Schemes
 - Outcome was deemed to be efficient, transparent and cost effective
 - No incumbent bias: **HSBC** was selected over Northern Trust and State Street
- **Pending**
 - Northamptonshire and Cambridgeshire (LGSS)
 - 2 others are in progress
 - 7 more are intending to call off shortly

First results of LGPS Collaboration on Custody Procurement

“Norfolk, Suffolk and Hackney Pension Funds have appointed HSBC Securities as custodian through the National Local Government Pension Scheme (LGPS) Frameworks. The three funds, with combined assets of £5.2bn, are expected to save a total of £1.25m over the lifetime of the contracts, with an additional £250,000 saved in procurement costs.”

- Professional Pensions, 19 May 2014

- *"This is **real collaboration in action**, already delivering real and significant savings and benefits for the LGPS today. The achieved and potential savings are very significant - based on evidence from the custody framework alone, as participation matures and grows, the LGPS could collectively benefit by more than £50m."*

- Nicola Marks, Norfolk County Council

LGPS Collaboration Custodian Framework Mechanics

- **Framework weighting**
 - 40% Quality – set Database questionnaire, scored and locked in
 - 40% Service Fit – customised questions to suit individual needs
 - 20% Fees – lower weight to prevent “buying” business
- **Fee Rebates**
 - 1% fixed rebate on total fees – to cover cost of running Framework
 - Tiered fee discounts based on total value of assets
 - Encourage participation
- **Results:**
 - Benefits – saves £millions, time, improves Scheme performance
 - Positive story for HM Government
 - Great result for LGPS: collaborative purchasing works!
 - We recommend **ongoing monitoring of custodian operations** to provide supporting data

Q&A

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SOUTH YORKSHIRE PENSIONS AUTHORITY

19 June 2014

Report of the Clerk

COMPLIANCE WITH MYNERS' PRINCIPLES: SELF ASSESSMENT

1) Purpose of the report

To inform Members of the outcome of the self-assessment against the Myners' Principles.

2) Recommendations

- a) **That the Authority notes the contents of the report.**
 - b) **That the Authority agrees to review this process when the new governance arrangements under the Public Service Pensions Act 2013 are known.**
 - c) **That the Authority agree to any development needs arising from the results.**
-

3) Background Information

- 3.1 Members adopted a system of self-assessment in October 2011 and agreed to use a template to gauge compliance.
- 3.2 Members received individual copies in January 2014 and were asked to retain them until the end of the financial year (March 2014) and return them, duly completed, to the Clerk and Treasurer.
- 3.3 Twelve forms were issued and nine were returned; this was a decrease on the previous year when ten of the twelve forms were returned.
- 3.4 The self-assessment was divided into three separate forms and not all members were required to complete all three. The assessments were: assessment of Authority Members (Form 1); assessment of the Board Chair by Members of the Investment Board (Form 2, Part A); assessment of the Independent Investment Advisors by the Members of the Investment Board (Form 2, Part B); assessment of the Board Chair by the Members of the Corporate Planning and Governance Board (Form 3)
- 3.5 The scoring mechanism used is a range of 1-5 as follows:

1 Poor; 2 Satisfactory; 3 Good; 4 Very Good and 5 Excellent.

4) Results

- 4.1 In relation to the assessment of the Authority Members, scores ranged from Satisfactory to Excellent. In the main, scores were either Very Good or Excellent and

therefore no areas of concern were raised and no development needs identified. Members felt that improvements had been made in the following areas:

- Working together as an effective unit
- Addressing trustee learning gaps.
- Monitoring the employers' performance under SLA's
- Reviewing the governing legislation regularly.

- 4.2 In relation to the assessment of the Board Chair by the Members of the Investment Board, scores ranged from Good to Excellent with the majority falling into the Good category.
- 4.3 In relation to the assessment of the Independent Investment Advisors by the Members of the Investment Board, scores again ranged from Good to Excellent with the majority falling into the Very Good category.
- 4.4 In relation to the assessment of the Board Chair by the Members of the Corporate Planning and Governance Board, scores again ranged from Satisfactory to Excellent, although it is fair to say that most criteria achieved a score of either Very Good or Excellent.

5. Development Needs

- 5.1 There appear to be no immediate development needs arising from the self-assessment.
- 5.2 The method of Member self-assessment will be reviewed when the new governance arrangements under the Public Service Pensions Act 2013 are known.

6. Implications

There are no direct financial, legal or diversity implications with this report.

There may be some reputational risk implications in relation to the quality of internal governance if results are not reported and acted on appropriately.

M McCarthy
Deputy Clerk

Officer responsible:
G Garrety
Democratic Services Officer
01226 772806

Background papers used in the preparation of this report are available for inspection at the offices of South Yorkshire Joint Secretariat, Barnsley.

Other sources and references: None.

SOUTH YORKSHIRE PENSIONS AUTHORITY

19 JUNE 2014

Report of the Fund Director

TRANSFORMING REHABILITATION PROGRAMME AND THE LGPS

1) Purpose of the report

To update Members' on progress surrounding the proposal to transfer the assets and liabilities of those current members of the Probation service in the Local Government Pension Scheme from the present thirty four administering authorities to the Greater Manchester Pension Fund.

2) Recommendation

That Members note the report.

3) Background information

3.1 I reported to the Authority in January that the Government intended to transfer of the assets and liabilities of current Local Government Pension Scheme members employed by the Probation Trusts from their present administering authorities to one single administering authority e.g. the Greater Manchester Pension Fund (GMPF).

3.2 Under the Ministry of Justice's Transforming Rehabilitation Programme those members of probation staff who are currently entitled to LGPS membership and who are to be employed in one of the 21 Community Rehabilitation companies (which are to be established and transferred into the private and voluntary sector) or the newly formed National Probation Service will be transferred from the current thirty four administering authorities to one administering authority. This is to be Tameside Metropolitan Borough Council in its role as administering authority of the GMPF. At the time I reported that the Government was expecting the transfer to become effective on 1 April 2014.

3.3 There are roughly 1400 probation members within the South Yorkshire Pension Fund. These represent about 1.0% of Fund membership. According to the 2013 actuarial valuation the value of the assets allocated to the probation service liabilities was just over £101m.

4) Progress

4.1 The requisite Statutory Instrument (2014 No 1146) was made on 1 May 2014 and came into force on 1 June 2014.

- 4.2 GMPF now anticipate that the initial calculation of the quantum of assets to be transferred (as at 1 June 2014) will be carried out before 1 November 2014. GMPF's actuary (Hymans Robertson) is in contact with the Fund's actuary (Mercers). Immediately prior to any actual transfer of assets an "estimated" quantum will be used to determine the value of assets actually initially transferred. There will also be a post-event "refresher" calculation.
- 4.3 GMPF are canvassing ceding funds as to how the assets are to be transferred. GMPF are suggesting a six month period beginning on 1 October and ending 31 March 2015 during which assets of roughly £100m per week will be moved.
- 4.4 At the moment officers have indicated to GMPF that this Fund would prefer to make a single payment of cash (rather than in specie) and to do so during early to mid-December 2014. This would be the least disruptive period for the Fund and would result in the outcome being known before the end of the current financial year. GMPF have indicated that a 0.20bps discount will be payable for cash transfers rather than in specie ones. Clearly there will be costs involved in this transaction.
- 4.5 In the interim this Fund will continue to service its probation members.
- 4.6 This outline programme is subject to change and refinement.

5) Implications

5.1 Financial

At the time of writing the value of assets to be transferred can only be estimated (c£105m at March 2014) and will need to be adjusted in accordance with agreed transfer dates. However, the value of the Fund will clearly be reduced as will the size of its liabilities. Other costs will be incurred as part of the transition process.

5.2 Legal

There are potential legal implications arising out of this report.

5.3 Diversity

There are no diversity implications.

5.4 Risk

There are a number of potential risks associated with this report depending upon the detailed outcome of the transfer.

J N Hattersley
Fund Director
Telephone contact 01226 772873

Background papers used in the preparation of this report are available for inspection at the offices of the Pensions Authority in Barnsley

SOUTH YORKSHIRE PENSIONS AUTHORITY

19 June 2014

Report of the Clerk

WEBCASTING

1. Purpose of the Report

To seek approval from Members for a renewal of the contract to webcast meetings of the Authority.

2. Recommendations

Members are recommended:

- a) **That the Authority contributes towards the annual cost of the webcasting contract for countywide bodies**
-

3. Background Information

- 3.1 Webcasting is the live broadcast of meetings over the internet with access via computer, tablet and smartphone. Members' contributions are time stamped so that the viewer can browse all contributions by a specified member or scroll to a particular debate. Individual items can be shared and commented upon via social media.
- 3.2 The hardware and software are leased from Public-i Ltd which also provide a helpdesk during the webcast and host an archive of the webcast for six months after the meeting.
- 3.3 The Authority has webcast its meetings since 2007, along with the other South Yorkshire Joint Authorities. In 2010, Public-i was awarded a three year contract which was extended for 2013/14.

4. Cost

- 4.1 A further renewal of the contract is proposed from 28 June 2014 to 27 June 2015, in which the Authority would contribute to the cost of webcasting by the other South Yorkshire Authorities and Police and Crime Commissioner. The total cost of renewal for one year (60 hours) is £14,151 + £1,300 broadband connection, which is divided between the Authorities:

Authority	Hours	Cost (£)
Pensions	6x2 hour meetings	4,172
Fire	16 meetings (including Audit Committee) 21 hours	5,407
Transport	8x2 hour meetings	2,781
SY Police & Crime Commissioner	11 hours	3,090
	60 hours	15,450

4.2 The renewal comes with a range of new facilities for analysing viewings, registering local residents, and building members' digital profile.

4.3 The integration of the Authority's administrative support with Barnsley MBC will provide an opportunity to include the facilities at Regent Street with those at the Town Hall in a single contract.

5. Transparency

5.1 The webcasting of the Authority supports transparency and engagement with stakeholders including employers and scheme members. The increased avenues for openness and accountability, which web technologies provide are important to gain public trust in the Authority's decision making.

5.2 Broadcasting meetings in this way encourages engagement and feedback, and overcomes exclusion: the hard of hearing can read a transcription, minority groups can read a translation, and citizens with reading difficulties can see and hear a streamed video.

5.3 There has been an average of 334 viewings of each of the Authority's last five meetings.

5.4 Up to 50 councils webcast, including Manchester, Birmingham Cheshire West and Cheshire, Leeds, Leicester and Leicestershire, Scarborough, York, and Glasgow and Edinburgh in the last year.

6. Implications

6.1 The financial implications have been set out above.

6.2 There is a low risk of legal action. This relates to the potential of defamatory statements by members of the Authority which are subsequently transmitted by webcast. However, the Authority can remove potentially defamatory statements from the archive copy of the webcast. The Authority's insurers have also stated the current liability policies will provide an indemnity in respect of any claims arising out of the webcast transmissions of Authority meetings.

M McCarthy
Deputy Clerk

Officer responsible:
L Kaplan
Information Manager
Tel 01226 772102

SOUTH YORKSHIRE PENSIONS AUTHORITY

Report of the Fund Director

19 JUNE 2014

REFERENDUM ON SCOTTISH INDEPENDENCE

1) Purpose of the report

To advise Members of some of the issues that might arise from and affect the Fund policies should the outcome of the Scottish Referendum on Independence be in favour of secession.

2) Recommendation

That Members note the report.

3) Background information

3.1 On 18 September 2014 a referendum on Scottish independence will be held. Notwithstanding the Authority's policy of political neutrality on such matters it is prudent to consider some of the potential consequences should the vote be in favour of independence. Even after the result of the vote is known there is likely to be a considerable period of uncertainty until all the implications are understood and quantified in relation to the legislative and regulatory environment in which the Fund operates. Should the vote be in favour Scotland is likely to secede from the United Kingdom some time in 2016.

3.2 Amongst the matters of significance would be currency arrangements, financial regulation and the tax regime of an independent Scotland. These, in turn, will be affected by the response of the United Kingdom government and whether or not the European Union or European Economic Area accept Scotland as a member state.

3.3 At the time of writing this report there are a number of material issues that remain uncertain. These include:-

- The currency that an independent Scotland would use
- Whether agreement and ratification of an independent Scotland's membership of the European Union would be achieved by the target date (24 March 2016)
- The shape and role of the monetary system
- The arrangements for financial services regulation and consumer protection in an independent Scotland
- The approach to taxation including reciprocity with the remaining UK countries and EU states.

- 4) Fund investment issues
- 4.1 Although not directly affecting this Fund it is worth noting that the current LGPS Investment and Management of Funds Regulations 2009 prohibit LGPS funds from appointing managers not regulated by EU or EEA states. It is almost certain that managers domiciled in Scotland will establish English or other subsidiaries to which that business could be transferred.
- 4.2 Investments in companies currently domiciled in Scotland would presumably have to be reclassified as overseas investments. At the moment, for example, there are more than forty investment trusts that are legally incorporated in Scotland. A change in domicile would also apply to any existing UK gilts etc apportioned to Scotland post secession. Legally redomiciling a stock is quite a complex process but not without precedent.
- 4.3 According to analysis published by NIESR, and echoed by the credit rating agency Fitch, if Scotland was to inherit a share of gross government debt based on its proportion of population and its geographical share of North Sea oil it would assume debts of c£143bn. Many observers argue that this sum is more than Scotland can bear. It would need to find approximately £23bn in the first year in addition to any borrowing required to meet the fiscal deficit. Therefore, NIESR argue that Scotland would need to establish a formal 'IOU' with the UK Treasury to cover this. Whilst the UK Treasury has announced that it will continue to guarantee all UK public sector debt NIESR state that credit rating agencies would not look favourably upon this arrangement and both the residual UK and Scottish ratings might be adversely affected. Fitch agrees that it would delay the return to a 'AAA' credit rating for the residual UK because there would be a jump in gross debt of c10%. Furthermore, the overall deficit as a percentage of GDP for the new UK would rise and at 5% it is already one of the highest in Europe. Longer term, though, Fitch believe independence would be mildly positive for residual UK because the demographics and financial outlook for Scotland is weaker than that for the remaining countries.
- 4.4 The Scottish Government disputes the NIESR report and states that based upon GDP per capita the independent country would rank within the top 20 economies in the world.
- 4.5 Properties located in Scotland would have to be reclassified as overseas assets notwithstanding any currency issues. There could be issues with supplier contacts where services are provided in both England and Scotland. There could be currency issues associated with rent collection, taxation, debt recovery and hedging. Indeed, Fitch argues that currency could prove to be more problematic going forward than the question about debt. Whatever option is decided upon – ranging from free float to currency union – the fact that 12% of residual UK trade will be with Scotland both entities will be impacted and, Fitch believe, both will be impacted adversely.
- 4.6 Of course, Scotland already operates a distinct legal system and this has not caused difficulties. It also has a different tax regime eg Stamp Duty Land Tax is scheduled to rise in September regardless of the outcome of the Referendum.

4.7 Scottish property holdings were valued at £26.45m or roughly 7.9% of commercial portfolio value as at end March 2014. When a look through basis is adopted the exposure via indirect vehicles increases the overall value to roughly £30m. Compared to the main IPD property index the Fund is overweight.

4.8 These observations might result in changes to benchmarks being required.

5) Fund administration issues

5.1 Fund members domiciled in Scotland would be affected by the currency and taxation issues already referred to.

5.2 Scottish Widows is one of the Authority's AVC providers. It is not clear how, if at all, independence would affect the relationship.

6) Implications

6.1 Financial

If the outcome of the vote is in favour of independence there will be direct implications arising from this report.

6.2 Legal

If the outcome of the vote is in favour of independence there will be direct implications arising out of this report.

6.3 Diversity

There are no diversity implications.

6.4 Risk

There are risks associated with this report but the details will necessarily have to await the outcome of the vote.

John Hattersley
Fund Director

Telephone contact 01226 772873

Background papers used in the preparation of this report are available for inspection at the offices of the South Yorkshire Pensions Authority

Other sources and references: Aberdeen Asset Management; Alliance Trust; CIPFA; Standard Life

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SOUTH YORKSHIRE PENSIONS AUTHORITY

19 June 2014

South Yorkshire Pension Fund Annual General Meeting 2014

1. Purpose of the Report

To advise members about the 2014 Annual General Meeting of the Fund.

2. Recommendations

Members are recommended to note Thursday 9th October for this years AGM.

3. Information

- 3.1 The 2014 Annual General Meeting will be held at the New York Stadium, Rotherham United Football Club, start time 5.30pm on Thursday 9th October.
- 3.2 Following the format of previous meetings the AGM will be held during the evening to allow maximum attendance. A light buffet will be served after the meeting has concluded and transport for Fund members will be arranged to and from the meeting.
- 3.3 Due to the decline in attendance over the last two years it has yet to be decided whether we continue with the regular format or whether we invite a guest speaker. We know from consultation that the regular attendees are happy with the existing format so it is unclear why the numbers are declining.

We recently issued a survey to LAPFF members asking for feedback on their own AGMs. The results didn't particularly highlight any immediate solution as the majority of funds that held AGM's (quite a few didn't) experienced the same attendance levels.

Our intention is therefore to advertise the meeting earlier and also through different channels. The meeting will be advertised in the newsletters which are to be issued in August, a month earlier than in previous years. For the first time we will also advertise the meeting in the annual pension forecast for active scheme members and to deferred members via their annual statement.

- 3.4 Full details of the meeting will be forwarded to Members closer to the date.

4. Implications and risks

Implications

- Financial

There is a provision within this year's budget to hold the event

- Legal

There are no legal implications

- Diversity

There are no diversity implications

Officer Responsible: **Joanne Webster**
Communications Manager
Telephone contact 01226 772915
E-mail jwebster@sypa.org.uk

Background papers used in the preparation of this report are available for inspection in the Pensions Administration Unit.

Other sources and references:

SOUTH YORKSHIRE PENSIONS AUTHORITY

19 JUNE 2014

Report of the Clerk to the Pensions Authority

MEMBER DEVELOPMENT ANNUAL UPDATE

1. Purpose of the Report

To provide an update on the learning and development arrangements for members of the Authority.

2. Recommendations

Members are asked to:

- 2.1 Approve the revised Learning and Development Strategy and request updates at future meetings.
- 2.2 Discuss the draft annual training plan and approve further development prior to implementation.
- 2.3 Nominate and appoint a Lead Member for Learning and Development.
- 2.4 Commit to a round of personal development reviews to be arranged with individual Members.

CONTENTS

Main Report

Appendix A Draft Learning and Development Strategy

Appendix B Draft Annual Training Programme 2014-15

Appendix C LGPS Trustee Training Fundamentals – 2014 programme

Appendix D Training Needs Analysis Questionnaire

3. Background Information

- 3.1 Previous reports to the Authority have identified the need for an effective training and development programme for Pensions Authority Members.
- 3.2 Continuous training and development is essential for every member of a public authority, and the introduction of more demanding governance requirements over the last 10 years has formalised the requirements. For Pensions Authorities, the need is accentuated because it is such a specialised area of local authority business, and involves responsibility for substantial levels of funds.
- 3.3 The Pension Regulator has issued a code of practice relating to governance and administration of public service pension schemes. The code sets out the standards expected by the regulator and sets out principles, examples and benchmarks to use to assess whether pension board members have sufficient knowledge and understanding for them to effectively carry out their role.
- 3.4 The Code of Practice states *'Schemes should establish and maintain policies and arrangements for the acquisition and retention of knowledge and understanding for their pension board members. Schemes should designate a person to take responsibility for ensuring that a framework is developed and implemented'*
- 3.4 Shortfalls in member capacity and development are likely to attract adverse reports from external auditors and the Government under the new requirements.

4. Aims of a member development programme

- 4.1 Learning and development is a continuous process:-
 - Induction training
New members of the Authority require initial training on the role of the Authority; how it is organised; the basics of the Local Government Pensions Scheme; and the mechanics of how the Fund manages its investments. The Authority uses the LGPS Trustee Training Fundamentals All new Members are expected to complete the 3 day training as a minimum requirement and any existing Members who have not yet completed the 3 day course. See appendix C for details of the 2014 programme.
 - Investment principles
All members need to undergo more specialised training on the principles of investment management, to satisfy the advisory requirements set by Myners etc.

- Specialised training
The investment world is continually developing, and members need to be aware of current thinking on issues such as performance monitoring, benchmarking, asset and liability modelling and specialised areas such as private equity, socially responsible investing, and hedge funds. This training can be achieved through attendance of individual members on courses or seminars, or the provision of in-house seminars.
- General update
Keeping all members up to date with what is happening on the LGPS, how the South Yorkshire Fund is performing, changes in legislation or regulations, and all the other developments in the Pensions and Investment world, can be covered by briefings, bulletins, Authority reports, circulation of journals and digests etc.

4.2 Training needs

Individual members' needs will vary according to their previous experience and the length of time that they have been a member of the Authority. To address this and enable flexibility within the learning and development programme, Members are asked to complete a personalised training needs analysis questionnaire. Bespoke training plans can then be developed.

5. Annual Training Plan – Next Steps

- 5.1 Training is planned and delivered over the municipal year.
- 5.2 Induction training needs to be completed for the most recently appointed members, and Individual training needs analysis questionnaires for all members, so that where necessary, specialised training can be arranged.
- 5.3 Based on the completion of this work, the Authority will be in a more informed position to take a view on the level of attendance at external seminars and conference, the provision of in-house seminars, and the circulation of briefing and information material.
- 5.4 An indicative training plan for the forthcoming municipal year is attached at Appendix B. This will be revised and updated as the year progresses to allow for additional sessions that may be required as and when any new issues arise.
- 5.5 All new Members plus any existing Members who have not yet completed the 3 day Fundamentals are expected to complete this as a minimum requirement of the Member Learning and Development programme.

- 5.6 An in-house ‘Fundamentals Refresher’ course is included in the schedule. This was introduced last year and was well received by Members as it provided an opportunity for new Members to consolidate their learning from the 3 day course, and provided an update for other Members.
- 5.7 The Pensions Regulator has signalled its intention to develop an e-learning programme for public – sector pension schemes. The toolkit is expected to be available in autumn this year and can be incorporated in to the learning and development schedule. Support can be provided for individual Members to enable them to complete the course.
- 5.4 There is already a budget provision for training costs, which will meet most if not all of the costs. The ongoing information work is undertaken largely by staff of the Authority and the Joint Secretariat.

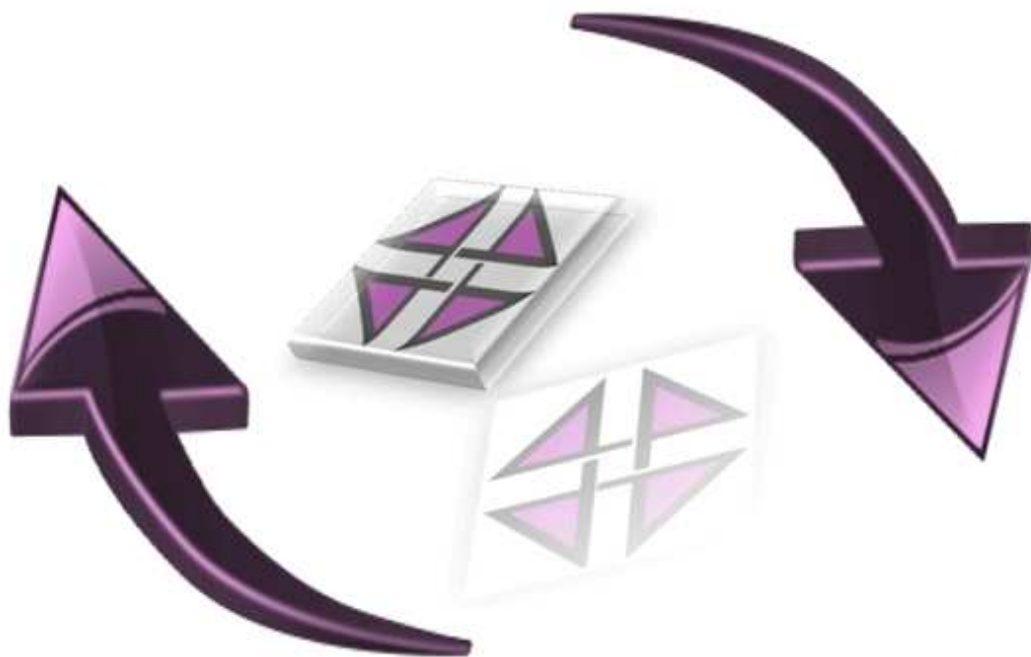
Report Author:	Name:	Rhona Bywater, SYJS Principal Policy and External Relations Officer
	e-mail:	rbywater@syjs.gov.uk
	Tel no:	01226 772851

Background papers used in the preparation of this report are available for inspection at the South Yorkshire Joint Secretariat, Barnsley.

Other sources and references:

The Pension Regulator Draft Code of Practice no.14
 Governance and Administration of Public Service Pension Schemes
 Published: Dec 2013

South Yorkshire Pensions Authority



Member Learning and Development Strategy

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Foreword from the Vice Chair South Yorkshire Pensions Authority

As Pensions Authority Members, our overriding responsibility is to act in the best interests of the present and future beneficiaries of the South Yorkshire Pension Scheme.

Members need to ensure the fund is managed in the most effective and efficient way so as to minimise the call on the public purse.

Members are not expected to be professional experts in investment matters. However, although we can delegate investment decisions and rely on investment advice, Members still define the framework and objectives. For that reason we need to ensure that we are familiar enough with the issues concerned and understand what is being proposed by the advisers and officers, in order to discharge our duties with due care, skill and prudence.

In order to perform our role successfully we need to build on the skills we already have as elected Members, and the learning and development we receive from our own District Councils. We then need to enhance those skills by expanding our knowledge and understanding about the role of the Authority, keep up to date with industry developments and best practice, and listen to and act on professional advice so that we are able to carry out our governance role effectively. I believe there is much for us to learn.

This Strategy provides a framework for identifying the learning and development that Pension Authority Members need to carry out their role. It is flexible to allow for the fact that individual Members have different skills, experience and knowledge and can be tailored to suit Member needs and capacity.

I hope that you will embrace the learning and development programme to help the Pensions Authority to meet its objective of providing effective and transparent governance.

Councillor Richard Wraith
Vice Chair SY Pensions Authority



1. Introduction

South Yorkshire Pensions Authority is committed to continuous improvement, innovation and value-for-money in the services it provides. Elected Members of the Pensions Authority receive independent support, advice and guidance to equip them with the necessary skills and knowledge to enable them to fulfil their role.

The purpose of the Learning and Development Strategy is to provide a framework for Members to access the support they need and enables the Authority to manage the risk of failing to meet its objectives if Members are not adequately trained and kept up to date on Pensions and Investment matters.

2. Reviewing the Strategy

The Strategy was agreed by Members at the Annual General meeting, and reflects the new approach to Member development which focuses on providing learning and development rather than formal training. The Strategy will be reviewed annually to keep pace with national and local changes.

Significant changes to the Local Government Pension Scheme (LGPS) have taken effect from April 2014, and Members will need to be equipped with the necessary skills and knowledge to understand the new scheme.

3. Corporate Strategy

The Member Learning and Development Strategy will be central to achieving the vision, values and strategic objectives. The full Corporate Strategy can be found on the following website [here](#): (ctrl and click to follow this link) or at:

www.southyorks.gov.uk

[Go to the Pensions Authority pages, Library](#)

4. Aims and Objectives

The overall **aim** of the Strategy is to provide clear direction and purpose in respect of learning and development in order to achieve:

- Well-equipped Members who are confident and able to carry out their roles effectively
- A consistent approach to Member learning and development
- Equality of opportunity

The **objectives** of the Strategy are given below. These will be delivered through a range of activities including improvements to the Member Induction process, courses, workshops, briefings, bulletins, mentoring etc.

- To establish an environment where Member learning and development is seen as an integral part of the governance role of Pensions Authority Members.
- To equip Members with the knowledge and skills necessary to deliver a high quality service that meets the six strategic objectives.
- To ensure all Members are provided with a level of learning and development appropriate to their roles and responsibilities on the Pensions Authority;
- To ensure learning and development is available to all Members irrespective of seniority, length of service and political affiliation;
- To enable Members to have a clearer understanding of their personal responsibility for continuous development and to facilitate this process.
- To provide learning and development in line with the commitment to equal opportunities.
- To improve the Authority following best practice for Member Learning and Development, and contribute to the vision to be an Authority which effectively demonstrates a commitment to excellence in everything it does.

5. Learning and Development

New Members

All new Members will be given a structured – and mandatory – **Induction programme** to support them in developing their role and become an effective Member of the Pensions Authority

Both New and Existing Members

An annual development discussion will be provided for all Members on a one-to-one basis to identify requirements or to ‘refresh’ existing knowledge. Outcomes and benefits will be identified during this discussion and personal learning and development records will be kept for all Members detailing courses, conferences and learning undertaken.

Development discussions will take place as soon after the annual meeting as possible to ensure any new Members are included in the process. Any knowledge, support or skills identified by existing Members in their

previous 'one-to-one' will be re-prioritised to take account of the existing budget. Additional requirements will also inform the forecast for the following year.

The Development discussions will include an annual self-assessment against the Myners Principles (see Addendum). Each Fund's Statement of Investment Principles should detail how they are following these Principles.

The outcome of the annual Development Discussions will be a Learning and Development Schedule for the municipal year. This will fall into two categories – **Authority needs** (where more than one Member has identified the same requirement or where legislation or new initiatives necessitate a workshop session) and **Individual needs**, e.g. role specific, personal or 'one-off' requirements.

Fundamentals is externally provided, bespoke LGPS training held over three days (not necessarily consecutive) for Pensions Authority Members.

Pensions Advisory Panel Members will be invited to take part in all learning and development sessions that are delivered internally. For external training such as the 3 day LGPS Fundamentals training, it is proposed that the Authority funds one place per year for an Advisory Panel Member to attend.

To ensure the allocated budget is used wisely **criteria for categorising learning and development** will be applied as follows:

- Does the learning support our Strategic Objectives?
- Does it represent value for money in terms of the benefits and outcomes?
- Will the learning increase the capacity of Members to carry out specific roles e.g. chairing skills or leadership programmes?
- Can the learning and development be delivered internally e.g. one to one sessions, bulletins, fact sheets?

6. Delivery

Members' commitments and personal circumstances will be taken into account to provide equality of opportunity where possible.

A range of approaches will be deployed to deliver learning and development and these are listed below. Any external requirements will be commissioned by the Joint Secretariat.

- Traditional – courses delivered by internal / external trainers.
- Workshops (usually held at the end of Pensions Authority meetings).
- Member bulletins, briefings and the Pensions Authority website.
- On-line Library.
- External conferences – through the normal process of selection.

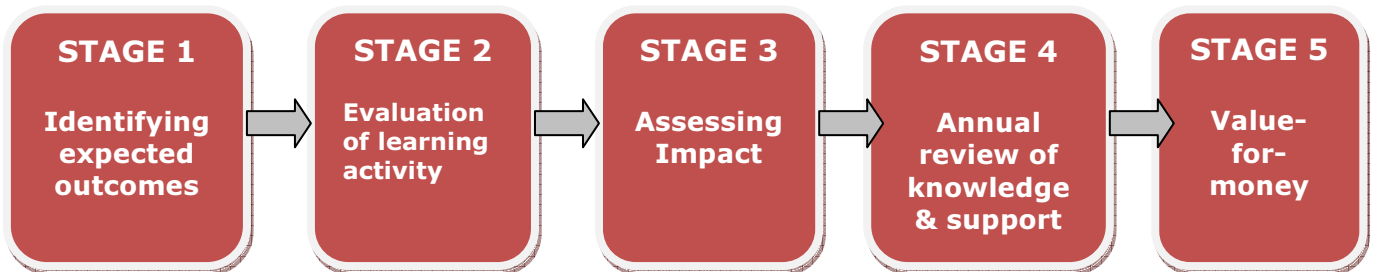
- Informal mentoring / 'coaching' via an established Member of the Pensions Authority.

Wherever possible, and appropriate, the Authority will work in partnership with other joint authorities and local authorities to share learning and development and any associated costs.

7. Monitoring and Evaluation

A five-stage evaluation process is proposed to monitor the success of the Member Learning and Development Strategy. This process is intended to measure the benefits to:

- Elected Members.
- Pensions Authority in meeting its priorities.
- Pensions Authority Stakeholders



Stage 1 – Identifying expected outcomes

- Establish expected outcomes – what do Members want to achieve from taking part in courses, workshops? e.g. gain a new skill, improve knowledge on a particular subject.

Stage 2 – Evaluation of learning activity

- Immediate response to learning activity.
- How relevant was the learning activity to agreed outcomes?

Stage 3 – Assessing Impact

- Check whether outcomes have been met via the annual Development Discussion.
- Feedback from others – trainers, other participants.
- Assess how attitude, knowledge or skill has improved and how this will be used / applied in the context of the Pensions Authority.

Stage 4 – Annual review of learning and development

- Review learning and development activity and identify new requirements, e.g. Member request, new legislation, new expectations, roles etc.

Stage 5 – Value-for-money

- Assess money spent against learning outcomes and performance measures to demonstrate value-for-money.

8. Resourcing the Strategy

We realise that funding is extremely limited, as is Members' time. The Learning and Development Strategy is not about spending additional money; it's about improving the effectiveness of what we do. Any additional costs over and above that budgeted for will need to be justified. Our aim is to find ways of informing Members and providing them with the necessary learning and development for minimal cost without compromising quality.

We will, therefore, ensure that all learning and development provided is targeted and carefully managed to maximise the benefits to both the Members and to the Authority.

9. Role of the Lead Member

The Lead Member role is a concept that was introduced as part of the revised Learning and Development Strategy. A Lead Member role description has been developed and for completeness this is given below:

Lead Members should:

- Take the lead on behalf of the Authority for a particular subject area recognising that, on occasion, they should have the freedom to act in a scrutiny or questioning capacity.
- Be the initial point of contact for the Service or others wishing to discuss issues informally or sound out views.
- Be the spokesperson at Authority meetings in respect of their particular area.
- Contribute to policy development locally and nationally as appropriate.
- Attend national or local meetings, seminars etc. in their area.
- Promote or represent the views and/or policies of the Authority in the public domain even if these are not their own views.
- Keep abreast of key developments and issues in their area.
- Receive briefings / information on their area as required from officers of the Service and/or Joint Secretariat.

Lead Members do not:-

- Have the power to commit the Authority to a course of action, or make a decision on its behalf.
- Have total accountability for their assigned area.

10. Further information

Further information on the Member Learning & Development Strategy can be obtained from:

Rhona Bywater, Principal Policy Officer

Tel: 01226 772851

Email: rbywater@syjs.gov.uk

or

Gill Garrety, Member Services Officer

Tel: 01226 772806

E-mail: GGarrety@syjs.gov.uk

Or on the Pensions Authority website via: www.southyorks.gov.uk

Addendum

MYNERS PRINCIPLES

Principle 1 – Administering authorities should ensure that:

- Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively monitor their implementation, and
- Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Principle 2 – Trustees should set out an overall investment objective(s) for the fund that takes account of the scheme’s liabilities, the strength of the sponsor covenant and the attitude to risk of both the trustees and the sponsor, and clearly communicate these to advisers and investment managers.

Principle 3 – In setting and reviewing their investment strategy, trustees should take account of the form and structure of liabilities. These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.

Principle 4 – Trustees should arrange for the formal measurement of the performance of the investments, investment managers and advisors. Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

Principle 5 – Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders’ Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents. A statement of the fund’s policy on responsible ownership should be included in the Statement of Investment Principles. Trustees should report periodically to members on the discharge of such responsibilities.

Principle 6 – Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives. Trustees should provide regular communication to members in the form they consider most appropriate.

SY Pensions Authority

Draft Learning and Development Programme 2014-15

This learning and development programme details a range of opportunities for elected members to develop their skills and knowledge. It covers some key issues and topics that will build on existing experience.

It aims to mirror the work programme to support the decisions Members need to take at set points in the yearly cycle of meetings.

Whilst learning and development has been opened up to all Joint Authorities, this Programme brings together some key learning opportunities and a draft timetable.

The programme is designed to be flexible and can be adapted to take account of any additional learning needs and emerging issues.

Proposed timescale	Event/Topic	Details /training provider/location /projected cost etc.
June 2014	Member Induction	Date tbc
	Responsible investment and proxy voting	
	Financial Awareness / Introduction to Finance	
July	Audit and Risk Management (or Effective Audit Committees)	After CPGB 24 July – Rob Winter/ Internal Audit
August	Early retirement and ill health financing	
September	Asset and liability issues arising out of the new LGPS proposals	
October	Schroders Trustee training	Leeds 19 Sept
	LGPS Trustee Fundamentals	Leeds 14 Oct
	Preparing for the new LGPS – Introduction to proposed changes to the scheme	After PA 2 Oct
November	LGPS Trustee Fundamentals Disputes & Complaints	Leeds 11 Nov After CPGB 13 Nov – GC
December	Treasury Management	
	LGPS Trustee Fundamentals	Leeds 2 Dec
Jan / Feb	LGPS Fundamentals	In-house 1 day fundamentals refresher – date tba

2015	Treasury Management	
	Data and Data Flows and appeals	<i>Date tba - possibly as part of the 1 day fundamentals refresher - GC</i>
March /April 2015		
throughout the year	Generic Joint Authority training opportunities: <ul style="list-style-type: none"> • Chairing Skills • Questioning and Listening • Read Faster Workshop (Speed Reading) • Treasury Management 	

DRAFT



The Local Government Pensions Committee
Secretary: Jeff Houston

CIRCULAR

Please pass on sufficient copies of this Circular to your Treasurer/Director of Finance and to your Personnel and Pensions Officer(s) as quickly as possible

No. 281 – MAY 2014

1) LGPS “TRUSTEE” TRAINING “FUNDAMENTALS XIII”

2) ANNUAL LGPS TRUSTEES’ CONFERENCE

3) EMPLOYER TRAINING – AUTO-ENROLMENT & THE LGPS

Purpose of this circular:

1. This Circular has been issued predominantly to advertise our forthcoming LGPS Trustees’ training programme “Fundamentals” but also as a reminder about this year’s annual trustee conference and a number of regional workshops for employers, all organised by the Local Government Pensions Committee (LGPC).

1) LGPS “TRUSTEE” TRAINING “FUNDAMENTALS XIII”

Background

2. Fundamentals is an A-Z bespoke Local Government Pension Scheme training course predominantly aimed at elected members serving on pension committees/panels, and has been attended by over 1030 delegates since 2002. The 2014 event incorporates all legislative changes made to the LGPS since last year’s event and all sections are refreshed to keep them up-to-date, relevant and interesting. Bearing in mind 1 April 2014 saw the introduction of a new “CARE” scheme, there are some significant changes to parts of the course material.

3. Despite these revisions, the aim of the LGPC remains unaltered; that is to deliver a single training course covering all aspects of the Scheme, including both “Benefits” and “Fund” administration, as well as “Investments”, so that attendees can
- demonstrate compliance with the first of the six CIPFA principles referred to in the Local Government Pension Scheme Regulations (and therefore being a statutory requirement);
 - receive educational material in line with CIPFA’s Pensions Knowledge and Skills Framework (KSF) for elected representatives and non-executives; and
 - adhere to those principles set out in the Pensions Act 2004 et seq that relate to the knowledge and understanding requirements that apply to trustees of occupational pension schemes.

Details of Fundamentals XIII 2014

4. The fundamentals course is run on an annual basis, and provides an insight into LGPS “trusteeship” for newly elected Committee members whilst also serving as an update/refresher course for longer-serving members. The course is of three days duration, spread over a number of months.

5. Fundamentals XIII 2014 will be delivered at three locations around the United Kingdom as follows:

Leeds	Day 1	14 October
	Day 2	11 November
	Day 3	02 December
Cardiff	Day 1	21 October
	Day 2	18 November
	Day 3	09 December
London	Day 1	28 October
	Day 2	25 November
	Day 3	16 December

6. The outline programme for the course is attached at Appendix A, although some flexibility on the course content is built in to include any major developments in the world of local government pensions between now and the time the courses run.
7. Fundamentals XIII 2014 is designed as a 3-day course, with identical material being delivered at each location. It is therefore possible to attend the course by visiting different locations should delegates’ diaries not allow attendance on all three days at a particular location.

Certificate of Attendance

- Attendees at all three sessions will receive an attendance certificate signed on behalf of the Local Government Pensions Committee. It is believed that attendance at all three days of the course will satisfy at least the minimum of training required to satisfy the first of the six CIPFA principles and also chime with CIPFA's Knowledge and Skills Framework.

Cost and booking

- The delegate rate for each session, inclusive of lunch, refreshments and all delegate materials is £230 plus VAT at the standard rate, making the cost of the three-day course £690 plus VAT.
- Early booking is highly recommended as places are limited. Bookings are made via the on-line events booking facility at <http://www.local.gov.uk/web/lgaworkforcepensions/training-and-events> which is part of the Local Government Association website. Please be sure to note our cancellation policy contained in our Terms and Conditions which you will be asked to confirm you have read when completing your booking details on the booking events page. You will also need full delegate details to hand including the address to which the invoice for payment is to be sent.
- If the session at your preferred location is full and you do not wish to book on one at an alternative location, you are advised to enter your name on the reserves' list at your preferred location. It is important to do so as, not only will you have a priority warning should any cancellations occur, but it also enables the LGPC to judge demand for future events or, on occasion, increase available delegate places.
- If you experience any difficulties in using the on-line website booking facility, please contact Elaine English, LGPS Executive Officer, by email elaine.english@local.gov.uk

Fundamentals XIII 2014 - Day 1

- 9.30 **Registration and Coffee**
- 9.50 **Introduction to the Programme**
- 10.00 **The Benefits Framework “Past and Present”**
- Brief history of the LGPS and its interaction with State provision
 - The 2014 Scheme – a core scheme plus discretions; a look at the comprehensive benefit structure of the scheme
 - Differences in the (draft) 2015 Scheme in Scotland
 - Administering Authority and Employing Authority Discretions
 - Pensions for Councillors
- 11.00 **Coffee Break**
- 11:15 **The Investment Framework**
- The Management and Investment of Funds Regulations 2009 – the statutory framework for investments
 - CIPFA Principles – a look at the six investment principles
 - Statement of Investment Principles
 - Interaction with the Funding Strategy Statement
 - Governance Compliance Statements
 - Annual Reports and Auditing
- 12:00 **Delivering the Service**
- Partnership Working
 - Framework Agreements
 - Financial Services procurement and relationship management
 - Supplier risk management
 - Performance of support services
- 12.30 **Lunch**
- 1.30 to 4:00 **(Break at 2:45)**
BACK TO BASICS - Traditional Asset Classes
 An explanation of:
- UK Equities, Overseas Equities
 - UK Gilts, UK Index-Linked Gilts
 - Corporate Bonds, Property
- Including a look at:
- Why invest in Fixed Income and Equity Markets?
 - Long Term Investment Performance of Equities and Fixed Income
 - Benchmarks used
 - Cashflows
 - The Bond Market
 - Return / Risk Profiles
- 4.00 **Close**

Fundamentals XIII 2014 - Day 2

- 9:30 **Registration and Coffee**
- 9:45 **Valuations**
- The Purpose of an Actuarial Valuation
 - Assets and Liabilities
 - How do liability calculations work?
 - What assumptions are used?
- Funding Strategy Statements**
- What is the funding strategy?
 - Different Employers – different characteristics and objectives
 - What is the strength of the covenant?
 - Deficit Recovery Periods
- 11:15 **Break**
- 11.30 **Corporate Governance**
- Approach to Corporate Governance
 - Voting, Activism and Engagement
 - Institutional Shareholders Committee principles
 - Socially Responsible Investment
- 12.30 **Lunch**
- 1.30 **Communication Strategies/Policies**
- Policy Statement Requirements
 - LGPS – Valuable part of employment package
 - Purpose and effect – Changes and Choices
 - A look at some good practice initiatives
- 2.00 to 4:00 **(Break at 2:45)**
- BACK TO BASICS 2 – Established Alternative Investments**
An explanation of:
- Private Equity, Commodities, Hedge Funds, Emerging Markets, Currency Funds, High Yield Bonds and Overlays
- Including a look at:
- The market evolution of Alpha and Beta
 - Private Equity sectors
 - Commodities – what do they cover and why include them in a portfolio?
 - The Hedge Fund universe
 - The background to Emerging markets
 - The value of Currency Funds and Currency Overlays
 - How High Yield Bonds fit into the Bond market
- 4:00 **Close**

Fundamentals XIII 2014 - Day 3

- 9:30 **Registration and Coffee**
- 9:45 **Duties and Responsibilities of Committee Members**
- The LGPS in its legal context
 - General local authority legal issues
 - LGPS specific duties and responsibilities
 - Wider duties and responsibilities
 - What happens when things go wrong?
- 11:15 **Break**
- 11:30 **The Future for the LGPS?**
- LGPS2014 – outstanding issues
 - Cost control mechanism
 - Pension Boards
 - Managing investment fees
- 12:30 **Lunch**
- 1:30 **New governance arrangements**
- The new, evolving requirements
 - Committee vs Board - delegation and representation
 - The governance budget
 - The Pension Regulator's involvement
- 2:15 to 4:00 **(Break at 2:45)**
- BACK TO BASICS 3 - Bringing it all together**
- The Evolution of LGPS Benchmarks
 - Portfolios and Portfolio Construction
 - Portfolio Concepts
 - Combining Assets in your Portfolio
 - Risks and Efficient Frontiers
 - Standard Deviation
 - Correlation
 - Diversification
- 3:55 **Course Review and Further Information**
- 4:00 **Close**

Distribution sheet

Local authorities who have registered for notification of Circulars
Pension managers (internal) of administering authorities
Pension managers (outsourced) and administering authority client managers
Officer advisory group
Local Government Pensions Committee
Trade unions
DCLG
COSLA
SPPA
Regional Directors
Private clients
Website

Visit the LGA's website at: <http://www.local.gov.uk>

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LGPC
Local Government House
Smith Square
London
SW1P 3HZ

or email: tim.hazlewood@local.gov.uk

or telephone: 01455 824850



MEMBER LEARNING AND DEVELOPMENT

QUESTIONNAIRE

1. Introduction

This questionnaire is designed to help you to identify the knowledge, support and skills you may need to fulfil your role as a Pensions Authority Member.

The role of a Pensions Authority Member differs from other roles you may carry out as a local councillor. Members act as Trustees with an overriding responsibility to act in the best interests of the beneficiaries, even if this is sometimes at odds with their political roles and responsibilities.

Furthermore, pension fund management is complex and, whilst Members are not expected to be professional experts in investment matters, a certain amount of technical knowledge and understanding is required to enable you to make informed judgements and decisions.

2. Completing the Questionnaire

There are several ways you can complete this questionnaire:

- ✦ Filling in a printed copy and sending it back to the Joint Secretariat (*details below*).
- ✦ By email – we will send you a copy of the form to fill in and return by email – see contact details below.
- ✦ Face-to-face with an officer from the Joint Secretariat at a date / time / location to suit you.
- ✦ Via telephone.

The process should take no longer than 30-45 minutes.

Please try and be as honest as you can in your assessment / discussion. Even if you are an experienced Member of the Pensions Authority, you may still find there are some areas you may wish to learn more about, or would benefit from additional development or support.

3. What happens next?

All completed Development Discussion questionnaires will be read and analysed to produce a comprehensive Learning and Development Schedule for the municipal year. This will consist of joint and individual learning and development either specific to the Pensions Authority, or more generic learning with other Joint Authorities or South Yorkshire Districts.

Members can also request learning and development at any time throughout the year – which will be assessed against the criteria in the Learning and Development Strategy to ensure fairness and value-for-money.

Additionally, there will be the externally-provided Fundamentals Training, which is the bespoke Local Government Pension Scheme (LGPS) training held over three days (not necessarily consecutive) and aimed specifically at Pensions Authority Members.

N.B. All new Members are expected to complete the 3 day training as a minimum requirement and any existing Members who have not yet completed the 3 day course

For Members who would like a refresh of the Fundamentals training, and following the success of the pilot last year, a one day overview of the three days is included in the draft learning and development strategy – date to be confirmed.

4. The Questionnaire

PERSONAL PROFILE	
Name	
District Authority	
How long have you been a Member of the Pensions Authority?	
What are your other (main) elected Member responsibilities / roles?	
Other relevant experience, e.g. professional, business, community	
What IT facilities and skills do you have?, e.g. e-mail, diary management, internet, Twitter, social media etc.	

KNOWLEDGE AND UNDERSTANDING		
<p>Please indicate – as honestly as you can – the level you think you are at using the scale below as a guide. Where appropriate, please use the ‘Comments’ column to indicate specific areas of knowledge where you would like additional knowledge, development or support.</p> <p>Level 1 - Unfamiliar / New to you 2 - Some knowledge but partial / limited 3 - Reasonably good level of knowledge and understanding 4 - Confident with an in-depth knowledge and understanding</p>		
Knowledge & Understanding	Level	Comments
The legal framework and design of the Local Government Pension Scheme (LGPS)		
The role and responsibilities of the Authority or as ‘quasi trustee’		
The role and responsibilities of the Pensions Authority Members		
Corporate governance and the Myners Principles for Pension Fund Trustees		
The roles and responsibilities of the Clerk and the Treasurer, Head of Pensions Administration and the Fund Director		

Role of the South Yorkshire Joint Secretariat (SYJS)		
Role of Actuary		
The whole range of SY Pensions Authority stakeholders (e.g. individual scheme members, local authority employers, other employers / admitted bodies and trade unions), and their different perspectives / needs		
Role of the Financial Conduct Authority (FSA)		
Asset classes and asset allocation		
Valuations and valuation monitoring		
Investment principles and management strategies		
Risk Analysis		
Setting performance benchmarks		
Funding strategies and monitoring		
SKILLS		
<p>Many of these skills apply to being an effective Member generally. Although being able to analyse information, think longer-term and make objective decisions are particularly important to your role as a Pensions Authority Member, communicating and influencing are also important to build and maintain the right links with your own Authority and the other employers.</p> <p>Again, use the levels suggested below, and make use of the 'Comments' column to tell us about any specific issues.</p> <p>Level 1 - Not very confident and / or inexperienced. 2 - Reasonably confident and / or experienced. 3. – Very confident and / or experienced.</p>		
Skill	Level	Comments
Understanding and handling numerical and financial information		
Digesting written and oral information and grasping key issues		
Using and monitoring performance management information (e.g. benchmarks)		
Thinking about the 'bigger picture' (nationally and locally) and the longer-term (10 years) issues for the Pensions Authority		
Being clear about the top level Authority objectives and its priorities		

Making sure you receive independent and informed advice and guidance that is understandable		
Being decisive, based on an objective assessment of all the issues and risks		
Being able to ask pertinent questions and to challenge officers and advisers constructively (overview and scrutiny)		
The ability to take the initiative to communicate with Members, officers, employers, unions etc.		
Keeping yourself up-to-date with issues pertinent to the Pensions Authority		

5. Your preferences

Everyone has preferred ways of learning and developing new skills. If you could indicate your preferences below this will help us to provide the right support tailored to your needs (where practicable). **Please tick all that apply.**

Reading – briefing papers, reports and periodicals	
Electronically through e-mail and website access	
One-to-one briefings and discussions	
Talks and verbal presentations	
Workshops and Seminars	
Conferences	

THANK YOU FOR COMPLETING THIS QUESTIONNAIRE

Please return completed form to:

Gill Garrety

Member Services Officer

SY Joint Secretariat

18 Regent Street

Barnsley

S70 2HG

Email: ggarrety@syjs.gov.uk

Tel: 01226 772806

By virtue of paragraph(s) 1, 2 of Part 1 of Schedule 12A of the Local Government Act 1972.

Document is Restricted

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