Haringey Council

Pensions Committee

MONDAY, 23RD JUNE, 2014 at 19:00 HRS - CIVIC CENTRE, HIGH ROAD, WOOD GREEN, LONDON N22 8LE.

MEMBERS: Councillors Bevan (Vice-Chair), Diakides (Chair), Doron, Marshall, Reith and Ross

Non-voting Members: Brown, Jones and Melling

AGENDA

1. APOLOGIES FOR ABSENCE (IF ANY)

To receive any apologies for absence.

2. INTRODUCTORY COMMENTS BY THE CHAIR

3. URGENT BUSINESS

The Chair will consider the admission of any late items of Urgent Business. (Late items of Urgent Business will be considered under the agenda item where they appear. New items of Urgent Business will be dealt with under Item 11 below.

4. DECLARATIONS OF INTEREST

A member with a disclosable pecuniary interest or a prejudicial interest in a matter who attends a meeting of the authority at which the matter is considered:

(i) must disclose the interest at the start of the meeting or when the interest becomes apparent, and
(ii) may not participate in any discussion or vote on the matter and must withdraw from the meeting room.

A member who discloses at a meeting a disclosable pecuniary interest which is not registered in the Register of Members' Interests or the subject of a pending notification must notify the Monitoring Officer of the interest within 28 days of the disclosure.

Disclosable pecuniary interests, personal interests and prejudicial interests are defined at Paragraphs 5-7 and Appendix A of the Members' Code of Conduct.

NOTE FROM THE ASSISTANT DIRECTOR OF CORPORATE GOVERNANCE AND MONITORING OFFICER

When considering the items below, the Committee will be operating in its capacity as 'Administering Authority'. When the Committee is operating in its capacity as an Administering Authority, Members must have due regard to their duty as quasi-trustees to act in the best interest of the Pension Fund above all other considerations.

5. TERMS OF REFERENCE OF THE PENSIONS COMMITTEE (PAGES 1 - 6)

To inform the Pensions Committee of its Terms of Reference as agreed by Full Council on 24 March 2014.

6. EXTERNAL AUDIT PLAN - 31 MARCH 2014 (PAGES 7 - 24)

The report presents the audit plan prepared by the external auditors, Grant Thornton for the audit of the Pension Fund accounts 2013/14 for the Committee's consideration.

7. PENSION FUND - REVIEW OF PRIOR YEAR ACTIVITY (PAGES 25 - 30)

The report summarises the pension's activity undertaken by the Corporate Committee in 2013/14 and highlights outstanding issues brought forward to the current year.

8. PENSION FUND - WORK PLAN 2014/15 (PAGES 31 - 36)

The report identifies topics that will come to the attention of the Committee in the year to March 2015 and seek Members input into future agenda's.

9. PENSION FUND QUARTERLY UPDATE (PAGES 37 - 54)

The Council is required to review investment performance on a quarterly basis, and sections 13 and 14 of the report provide the information for this.

10. DCLG CONSULTATION RESPONSE - OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFECTIVENESS (PAGES 55 - 92)

The Department for Communities and Local Government has issued a consultation document 'Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies'. The Council's proposed response is attached for consideration.

11. ANY OTHER BUSINESS OF AN URGENT NATURE

To consider any items admitted at item 3 above.

12. DATE OF NEXT MEETING

Thursday 18th September 2014 at 7.00pm

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Friday, 13 June 2014

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Agenda Item 5

Haringey Council

Report for:	Pensions Committee: 23 June 2014	**Item number**	

Title:	Terms of Reference of the Pensions Committee

Report authorised by :	Assistant Director of Corporate Governance and Monitoring Officer

Lead Officer:	Oliver Craxton (Tel. 020 8489 2615)

Ward(s) affected: Not applicable	**Report for Key/Non Key Decision:** Not applicable – for information.

1. **Describe the issue under consideration**

   To inform the Pensions Committee of its Terms of Reference as agreed by Full Council on 24 March 2014.

2. **Cabinet Member Introduction**

   Not applicable.

3. **Recommendations**

   That the report be noted.

4. **Other Options Considered**

   Not applicable.

5. **Background Information**

5.1 Full Council, at its meeting on 24 March 2014, agreed to the establishment of a Pensions Committee with effect from 1 April 2014.

5.2 Prior to the Full Council meeting pensions matters had been within the remit of the Council's Corporate Committee. However, Full Council were

Haringey Council

informed that the benefits of establishing a pensions committee were (1) to free up Corporate Committee time for non pension issues, (2) to better manage the training and knowledge and skills requirements through a smaller focused committee, and (3) to streamline decisions by having detailed debates at the decision making Pensions Committee rather than the non-decision making Pension Working Group, which will rarely be required in future.

5.2 Pension fund issues previously occupied a significant proportion of the Corporate Committee's available time. Proposals to reform Local Government Pension Schemes (LGPS) will introduce additional governance requirements. In particular there will be a need to demonstrate that members taking decisions have sufficient knowledge and skills to understand the issues. This will involve both increased training and periodic assessments of the effectiveness of training. Meeting these requirements within a dedicated Pensions Committee is more achievable than when applied to the larger Corporate Committee.

5.3 Full Council were further informed that an additional advantage of establishing a Pensions Committee was that the detailed monitoring, currently undertaken by the Pension Working Group, can be assumed by the Pensions Committee thereby streamlining decision making.

5.4 During 2013 the Government consulted on the LGPS governance arrangements and is expected to require the establishment of a Pensions Board with employee and pensioner representation to scrutinise the work of the Pensions Committee. Should the Government regulate as expected this will require a second pension related entity to be established to carry out the scrutiny function, although the decision making responsibility will remain with the Pensions Committee.

6. Comments of the Chief Financial Officer and Financial Implications

6.1 Most committee time is devoted to investment matters although it should be noted that employer and member issues fall within the remit of the Committee.

6.2 The terms of reference should be kept under review and revised both to reflect changes in regulation but also the Committee's appraisal of its role.

6.3 There are no direct financial implications arising from the contents of this report.

7. Assistant Director of Corporate Governance Comments and Legal Implications

Haringey Council

Where appropriate these are contained in the individual delegations.

8. **Equalities and Community Cohesion Comments**

   N/A

9. **Head of Procurement Comments**

   N/A

10. **Policy Implications**

    N/A

11. **Use of Appendices**

    Appendix 1 – Terms of Reference of the Pensions Committee.

12. **Local Government (Access to Information) Act 1985**

    N/A

Background Papers

The following background papers were used in the preparation of this report:

Report on ‘Establishment of a Pensions Committee from 1 April 2014’ submitted to Full Council on 24th March 2014.

The background papers are located at River Park House, 225 High Road, Wood Green, London N22 8HQ

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Appendix 1

Pensions Committee – Terms of Reference

(a) To exercise the functions which are stated not to be the responsibility of The Executive in Regulation 2 and Schedule 1 paragraph H of The Local Authorities (Functions and Responsibilities) (England) Regulations 2000 (as amended) and in any Statute or subordinate legislation further amending these Regulations relating to those matters concerning the Local Government Pension Scheme. The Committee's functions are those of the "Administering Authority" under the Pensions legislation.

(b) Exercising all the Council's functions as "Administering Authority" and being responsible for the management and monitoring of the Council's Pension Fund and the approval of all relevant policies and statements. This includes:

(i) Selection, appointment and performance monitoring of investment managers, AVC scheme providers, custodians and other specialist external advisers;
(ii) Formulation of investment, socially responsible investment and governance policies and maintaining a statement of investment principles and funding strategy statement;
(iii) Determining the allocation of investments between each asset class;
(iv) Reviewing specialist external advisers performance;
(v) Publicising statements and policy documents as required by legislation, government directives and best practice.

(c) To monitor and as appropriate to decide upon Pensions Administration issues.

(d) Monitoring the Pension Fund Budget including Fund expenditure and actuarial valuations; and to receive the Pension Fund Budget annually.

(e) To agree to the admission of bodies into the Council's Pension scheme.

(f) To receive actuarial valuations.

(g) To ensure that members of the Committee receive appropriate training to undertake their responsibilities.

(h) To approve the Annual Accounts of the Local Government Pension Scheme and consider recommendations from the Auditor.

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Haringey Council

Report for:	Pensions Committee 23rd June 2014	**Item number**	

Title:	Pension Fund External Audit Plan 2013/14

Report authorised by :	Assistant Director – Finance (CFO)

Lead Officer:	George Bruce Head of Finance – Treasury & Pensions george.bruce@haringey.gov.uk 020 8489 3726

Ward(s) affected: N/A	**Report for** Non Key Decision

1. Describe the issue under consideration

1.1 This report presents the audit plan prepared by the external auditors, Grant Thornton for the audit of the Pension Fund accounts 2013/14 for the Committee's consideration.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 That the 2013/14 Audit Plan prepared by Grant Thornton be agreed.

4. Other options considered

4.1 None.

5. Background information

5.1 The audit plan will be presented by Paul Jacklin, the Audit Manager from Grant Thornton.

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5.2 The plan sets out the approach the auditors will take, the key issues, timescales, staffing and fee for the audit. The key pages are:

Pages 4 & 5 – overview of LGPS developments.

Page 6 – summary of the audit approach

Pages 7-9 – identification of the main risks relating to the misstatement of the annual accounts and the audit procedures that will be applied.

Page 13 – the auditor's reporting framework

5.3 Officers will provide the auditors with all necessary information during the audit which will take place during July. Grant Thornton will then report back to the Pension Committee in September on their findings and any recommendations.

6. Comments of the Chief Financial Officer and financial Implications

6.1 Grant Thornton is proposing a fee of £21,000 for the 2013/14 audit, which is £1,379 less than the prior year fee.

7. Assistant Director of Corporate Governance comments and Legal Implications

7.1 The Assistant Director of Corporate Governance has been consulted on the content of this report. The audit is in line with the Council's duty as administering authority for the Haringey Pension Fund.

8. Equalities and Community Cohesion Comments

8.1 There are no equalities issues arising from this report.

9. Head of Procurement Comments

9.1 Not applicable

10. Policy Implications

10.1 None.

11. Use of Appendices

Haringey Council

11.1 Appendix 1: Grant Thornton – The Audit Plan for London Borough of Haringey Pension Fund for year ended 31st March 2014

12. Local Government (Access to Information) Act 1985

12.1 Not applicable.

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The Audit Plan for London Borough of Haringey Pension Fund

Year ended 31 March 2014

March 2014

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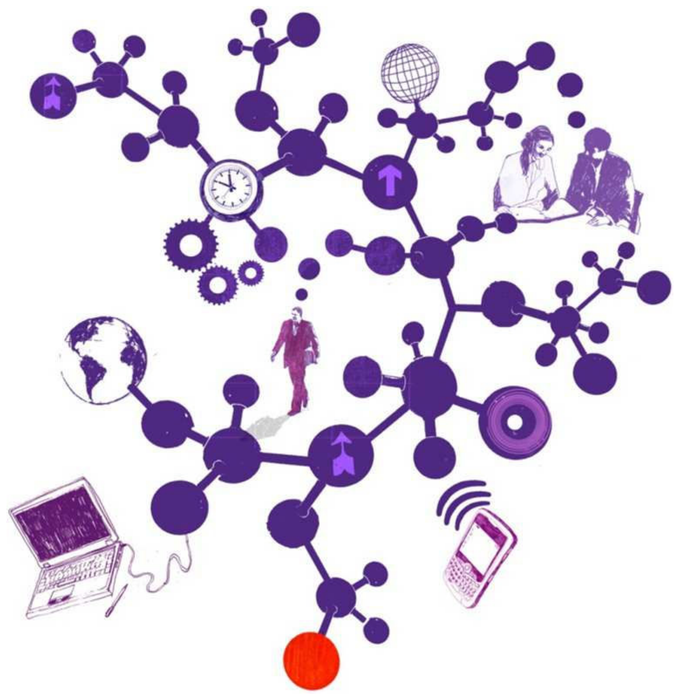

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Council or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Contents

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Understanding your business

In planning our audit we need to understand the challenges and opportunities the Pension fund is facing. We set out a summary of our understanding below.

Challenges/opportunities

1. LGPS 2014

- The Public Service Pensions Act 2013 (the Act) and associated regulations, alongside other important provisions, replace the current final salary scheme with a career average revalued earnings scheme (LGPS 2014).
- The new scheme will be more complex, requiring changes to systems and processes.

2. New governance arrangements

- The Act introduces an increased governance regime requiring that each scheme appoint a Scheme Manager who will be assisted by a Pension Board.
- The CLG has consulted on these and regulations are expected in 2014 with implementation expected by April 2015 at the latest.

3. The Pensions Regulator

- The Act also provides for The Pensions Regulator (TPR) to oversee the operation of LGPS schemes and set standards of governance and administration.
- The Fund will need to monitor compliance with requirements set by TPR.

4. Administration costs/ structural change

- Call for evidence on the future structure of the LGPS signalled the CLG's intention to consult on the future structure of the LGPS to improve efficiency and performance.
- LGPS management expenses are increasingly under scrutiny – in response CIPFA intend to issue guidance on reporting these in 2014.

5. Local government restructuring and outsourcing

- With increased outsourcing of services and Directions which require equivalent pensions to be provided to transferred staff, LGPS funds are admitting more private companies.
- The increased number of admitted bodies may increase risks for the Fund in the event of those companies failing.

Our response

1. LGPS 2014

- We will discuss with officers progress and implementation of LGPS 2014. Where appropriate, we will report any observations on implementation from 1 April 2014.
- As part of our 2014/15 audit we will consider changes to the pensions administration control environment in response to LGPS 2014 data requirements.

2. New governance arrangements

- We will consider Fund's revised governance arrangements as they develop and share good practice on emerging new arrangements.

3. The Pensions Regulator

- Where useful, we will share our experience of working with TPR as the Fund prepares for the new regulatory regime.
- From 1 April 2015, we will consider our reporting responsibilities to TPR. We will discuss any report with officers and the Pension Fund Committee.

4. Administration costs/ structural change

- We will share good practice in reducing administration costs through collaboration or other initiatives.
- Once issued, we will consider the CIPFA guidance and discuss with officers.
- We will discuss any proposals for structural change and their impact on the Fund with officers.

5. Local government restructuring and outsourcing

- Through our regular liaison with officers we will consider the impact of any planned large scale TUPE transfers of staff and the effect on the Fund.

Developments relevant to your Pension Fund and the audit

In planning our audit we also consider the impact of key developments in the sector and take account of national audit requirements as set out in the Code of Audit Practice and associated guidance.

Developments and other requirements

1. Financial reporting

There are no significant changes to the Pension Fund financial reporting framework as set out in the CIPFA Code of Practice for Local Authority Accounting (the Code) for the year ending 31 March 2014.

2. LGPS 2014

Planning and implementing of the Career Average Re-valued Earnings scheme (CARE), effective from 1 April 2014, will impact on the workload of the pensions administration team. This alongside, further developments in relation to governance may impact on the capacity to respond to audit queries.

3. Triennial valuation

Following the 31 March 2013 actuarial valuation the Council is in the process of considering the level of additional employer deficit contributions required and how to fund them.

4. Financial Pressures – Pension fund

Pension funds are increasingly disinvesting from investment assets to fund cash flow demands on benefit and leaver payments that are not covered by contributions and investment income. Pension fund investment strategies need to be able to respond to these demands as well as the changing nature of investment markets.

Our response

1. Financial reporting

We will ensure that the Pension Fund financial statements comply with the requirements of the Code through our substantive testing.

2. LGPS 2014

We will discuss the impact of the changes through our regular meetings with management.

We will plan our audit and agree timetables with officers to ensure that the audit of the Fund causes minimal disruption to officers.

3. Triennial valuation

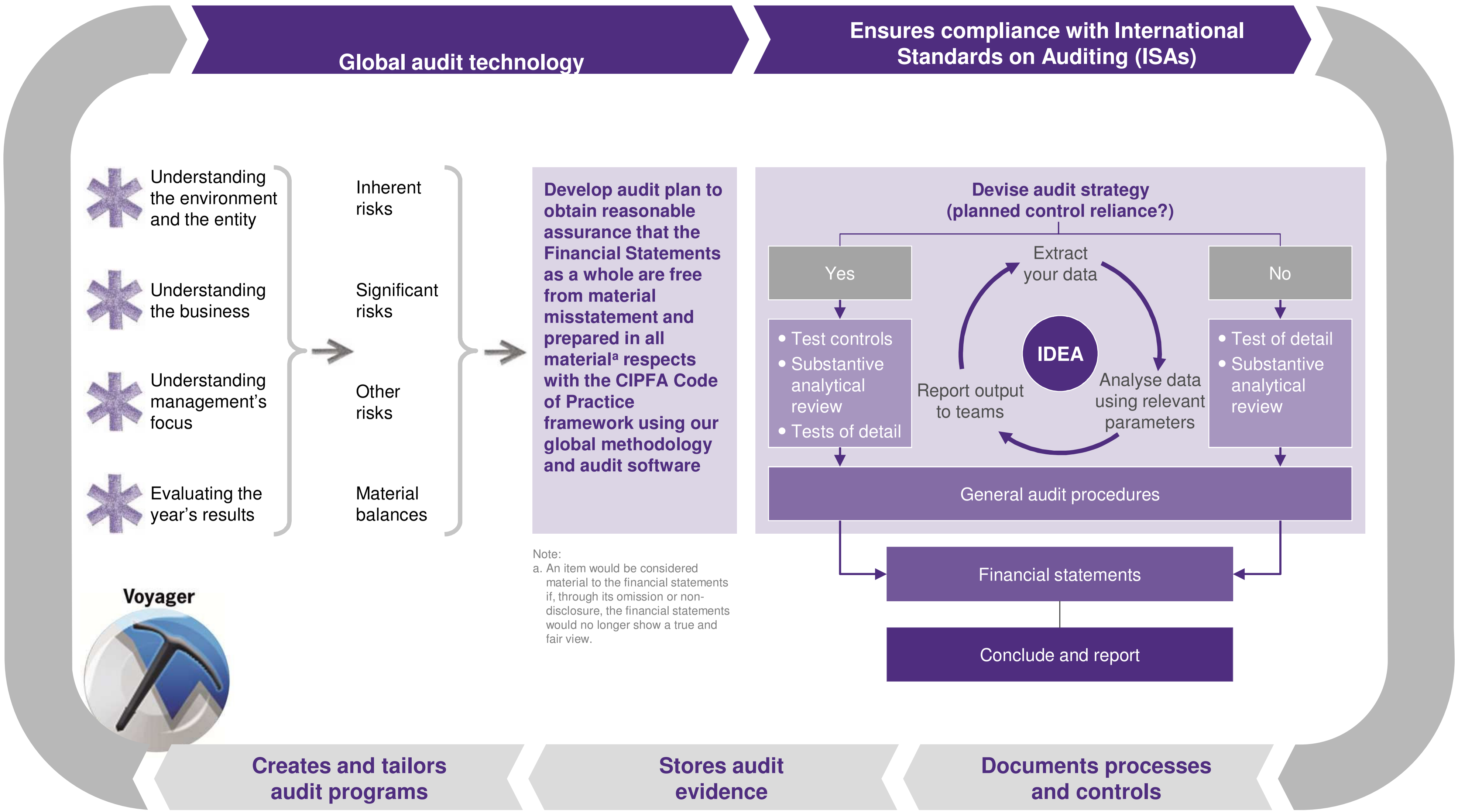
We will maintain regular dialogue with management to assess the impact this has on the administration of the pension fund and any required disclosures in the 2013/14 financial statements.

4. Financial Pressures – Pension fund

We will monitor the changes being made to the Fund investment strategy through our regular discussions with management.

We will consider the impact of changes on the nature of investments held by the pension fund and adjust our testing strategy as appropriate.

Our audit approach



Note:
a. An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true and fair view.

Significant risks identified

'Significant risks often relate to significant non-routine transactions and judgemental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgemental matters may include the development of accounting estimates for which there is significant measurement uncertainty' (ISA 315).

In this section we outline the significant risks of material misstatement which we have identified. There are two presumed significant risks which are applicable to all audits under auditing standards (International Standards on Auditing – ISAs) which are listed below:

Significant risk	Description	Substantive audit procedures
Revenue	Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.	We have rebutted this presumption and therefore do not consider this to be a significant risk for London Borough of Haringey Pension Fund since: • The nature of the Fund's revenue is in many respects relatively predictable and does not generally involve cash transactions. • The split of responsibilities between the Pension Fund, the Custodian and its Fund Managers provide a very strong separation of duties reducing the risk around investment income. • Revenue contributions are made by direct salary deductions and direct bank transfers from admitted /scheduled bodies and are supported by separately sent schedules and are directly attributable to gross pay making any improper recognition unlikely. • Transfers into the scheme are all supported by an independent actuarial valuation of the amount which should be transferred and which is subject to agreement between the transferring and receiving funds.
Management over-ride of controls	Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities.	• Review of accounting estimates, judgements and decisions made by management • Testing of journal entries • Review of unusual significant transactions

Other risks

The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities, over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures (ISA 315).

Other reasonably possible risks	Description	Planned audit procedure
Investments	Investments not valid Investments activity not valid Alternative Investments not valid Fair value measurement not correct	We will review the reconciliation between information provided by the fund managers, the custodian and the Fund's own records and seek explanations for any variances. For unquoted investments we will critically assessing the assumptions used in the valuation and check valuations to the latest audited financial statements of the respective investment fund. The existence of investments will be confirmed directly with to relevant documentation. We will test a sample of purchases and sales during the year back to detailed information provided by the fund managers.
Benefit Payments	Benefits improperly calculated/claims liability understated	We have confirmed the existence of controls operated by the Fund to ensure that all benefits are correctly calculated and that the appropriate payments are generated and recorded. With a view to reducing the level of substantive testing required, we will then test the key controls identified in these areas. We will then select a sample of individual transfers, pensions in payment , lump sum benefits and refunds and test them by reference to member files. We will rationalise pensions paid with reference to changes in pensioner numbers and increases applied in the year together with comparing pensions paid on a monthly basis to ensure that any unusual trends are satisfactorily explained.

Other risks

The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities, over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures (ISA 315).

Other reasonably possible risks	Description	Planned audit procedure
Contributions	Recorded contributions not correct	We have confirmed the existence of controls operated by the fund to ensure that it identifies and receives all expected contributions from member bodies. We will test controls to ensure all contributions are received by the Fund. We will substantively test contributions deductions from the Administering Authority. We will also review contributions received with reference to changes in member body payrolls and numbers of contributing members to ensure that any unexpected trends are satisfactorily explained.
Membership Data	Member data not correct	We have confirmed the existence of controls and reconciliations covering the determination of member eligibility, the input of evidence onto the Pensions Administration System and the maintenance of member records. With a view to reducing the level of substantive testing required, we will then test the key controls identified in these areas.

Interim audit work

Scope

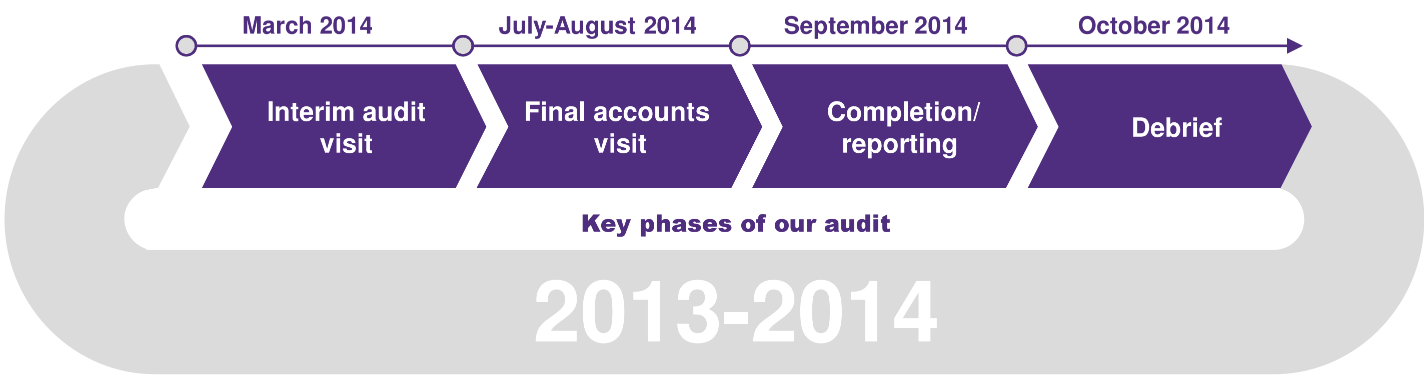
As part of the interim audit work, and in advance of our final accounts audit fieldwork, we will consider:

- the effectiveness of the internal audit function
- internal audit's work on the Pension fund's key financial systems
- walkthrough testing to confirm whether controls are implemented as per our understanding in areas where we have identified a risk of material misstatement
- a review of Information Technology (IT) controls

	Work performed and findings	Conclusion
Internal audit	We have reviewed internal audit's overall arrangements in accordance with auditing standards. Our work has not identified any issues which we wish to bring to your attention.	Overall, we have concluded that the Internal Audit service continues to provide an independent and satisfactory service to the Fund and that we can take assurance from their work in contributing to an effective internal control environment at the Fund. Our review of internal audit work has not identified any weaknesses which impact on our approach.
Walkthrough testing	We have completed walkthrough tests for contributions, benefits payable and member data. We are yet to complete the walkthrough for Investments as processes are undertaken at the year end. We will complete this walkthrough at the year end. Our work has not identified any issues which we wish to bring to your attention. Internal controls have been implemented in accordance with our documented understanding.	Our walkthroughs of contributions, benefits payable and member data has not identified any weaknesses which impact on our audit approach.
Journal entry controls	We will review the Pension Fund's journal entry policies and procedures as part of determining our journal entry testing strategy. We will then review all pension fund journals raised during 2013/14. We will extract and test any 'unusual' and large journal entries.	This testing will be undertaken as part of our post statements testing. The results of which will be reported to the Pension Fund Committee in September 2014.

Logistics and our team

The audit cycle



Date	Activity
21 November 2013	Planning meeting
March 2014	Interim site work
June 2014	The audit plan presented to Pensions Committee
July 2014	Year end fieldwork commences
August 2014	Audit findings clearance meeting
September 2014	Findings reported to Pensions Committee

Our team

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Fees and independence

Fees

	£
Pension fund audit	21,000

Fees for other services

Service	£
None	Nil

Our fee assumptions include:

- Our fees are exclusive of VAT
- Supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- The scope of the audit, and the Pension Fund and its activities have not changed significantly
- The Pension fund will make available management and accounting staff to help us locate information and to provide explanations

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Audit Findings report at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

Communication of audit matters with those charged with governance

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

This document, The Audit Plan, outlines our audit strategy and plan to deliver the audit, while The Audit Findings will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

We will communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to those charged with governance.

Respective responsibilities

This plan has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council and Pension fund's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice (the Code) issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Pension fund's key risks when reaching our conclusions under the Code.

The audit of the Pension fund's financial statements does not relieve management or those charged with governance of their responsibilities.

Our communication plan	Audit plan	Audit findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issue arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

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Haringey Council

Report for:	Pensions Committee 23rd June 2014	**Item number**	

Title:	Pension Fund – Review of Prior Year Activity

Report authorised by :	Assistant Director – Finance (CFO)

Lead Officer:	George Bruce, Head of Finance – Treasury & Pensions George.bruce@haringey.gov.uk 020 8489 8621

Ward(s) affected: N/A	**Report for** Non Key Decision

1. Describe the issue under consideration

1.1 The purpose of the paper is to summarise the pension's activity undertaken by the Corporate Committee in 2013/14 and highlight outstanding issues brought forward to the current year.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 The Committee is invited to note the pensions issues discussed in the last twelve months and in particular those items carried forward into next years work plan.

4. Other options considered

4.1 None.

5. Background information

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5.1 The Pensions Committee has assumed responsibilities previously allocated to the Corporate Committee. With the change in committee membership there is likely to be a knowledge gap on pension matters recently discussed by the Corporate Committee. This note briefly summarises activity in the last twelve months, highlighting outcomes and actions carried forward.

6. Comments of the Chief Finance Officer & financial implications

6.1 The report highlights the major pension fund developments over the last twelve months and those aspects carried forward. There are no specific financial considerations.

7. Assistant Director of Corporate Governance comments and Legal Implications

7.1 The Council as administering authority for the Haringey Pension Fund has the power to invest fund monies as set out in Local Government Pension Scheme (Management and Investment Funds) Regulations 2009.

7.2 There are no legal issues within the paper.

8. Equalities and Community Cohesion Comments

8.1 Not applicable.

9. Head of Procurement Comments

9.1 Not applicable.

10. Policy Implications

10.1 None.

11. Use of Appendices

Appendix 1: Strategic Asset Allocation

12 Local Government (Access to Information) Act 1985

12.1 Not applicable.

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13. Employer Issues

Actuarial Valuation

13.1 The Council's actuary, Hymans Robertson, completed the tri-annual actuarial valuation of the fund as at 31st March 2013. The purpose of the valuation is to determine the level of employer contributions payable in the three years from 1st April 2014.

13.2 The Actuary determined that at the whole scheme level the fund had an excess of liabilities (future pension promises) over assets of £370 million, representing a funding level of 70%. Contribution levels are determined separately for each individual employer. For example, the Council's rate will increase by 2% from 22.9% to 24.9% in the three years to 31st March 2017. The deficit will be addressed through anticipated investment returns and deficit contributions from employers.

13.3 The pension administration team monitor that employers' pay the new contribution rates.

13.4 The Actuary has estimated the funding level and deficit as at 30th April 2014 and this has improved with an estimated deficit of £328 million (73.4%funding level) as a consequence of rising equity markets.

13.5 The funding strategy statement was updated to reflect the revised assumptions used in the valuation and following consultation with employers. This document is normally updated every three years.

Changes in Employer Make up

13.6 There was an increase of 2 to 43 in the number of employers contributing to the fund during the year. The scheme has 20,094 members (6,168 active, 7,212 deferred and 6,714 pensioners).

14. Member Issues

14.1 The benefit structure for future service changed from a final salary scheme to a career average scheme from 1st April 2014. Across all LGPS funds career average based pensions are expected to be a less costly (therefore less generous) benefit structure, although the position for each member will depend on age and salary progression. Similarly, most, but not all employers will save as a consequence of the new benefit structure. The benefit structure changes have significant implications for the record keeping obligations of the Council and will complicate the calculation of benefits. Associated changes include the introduction of a reduced pension entitlement in exchange for lower member contributions (50/50 option).

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14.2 Member contributions for high earners have also increased from April 2014.

14.3 The Council's date to implement auto-enrolment was March 2013. These rules require that all employees who have not previously joined the pension scheme must be brought in but then have the opportunity to opt out. The process is repeated every three years for any non joiners. The Council (as an employer) opted to defer the introduction of auto-enrolment for existing staff until June 2017 under transition provisions. However, all new recruits and any member of staff who has a change of role, is immediately subject to auto-enrolment. Again, this is a significant administrative challenge.

15. Investment Strategy and Fund Managers

15.1 In conjunction with the actuarial valuation, the Corporate Committee reviewed the allocations to individual asset classes (equities, bonds etc). The purpose of the review was to identify a balance of assets that was likely to generate sufficient returns to address the funding level deficit (see 13.2) and avoid unnecessary risk that the funding level would deteriorate.

15.2 The revised strategy is summarised in appendix 1. The allocation to equities was initially reduced by 10% and with the creation of new allocations to infrastructure debt and multi-sector credit.

15.3 The Corporate Committee agreed to appoint two new fund managers, each to be awarded mandates valued at £45 million. These are:

Allianz – infrastructure debt.
CQS – multi sector credit

15.4 Discussions are underway with both managers on the legal documents to be signed and it is anticipated that this will be finalised by the end of June. The CQS mandate will be funded soon after signature but Allianz will take 12-18 months to be fully invested as Allianz seeks suitable investment opportunities.

15.5 The Corporate Committee also discussed a reduction in the index linked portfolio from 15% to 10% through a move to a leveraged index linked fund. This would allow a doubling of the CQS mandate from £45 million to £90 million. Concerns on the structure of the leveraged fund resulted in this decision being deferred and it will be brought forward in 2014-15.

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15.6 The other main change to the investment portfolio was to increase the investment in the property portfolio by £35 million. The target allocation to property remained 10%, but the actual allocation has fallen to under 7%. The Corporate Committee decided to revert to the benchmark allocation to be funded by a reduction in the actual (not the strategic) allocation to equities.

15.7 So far an additional £17 million has been invested in property. Cash is made available to the manager, CBRE, as they identify suitable opportunities, which is expected to take a further 3-6 months.

15.8 The Statement of Investment Principles has been updated to reflect the above changes in investment policy.

16. Collective Investment Vehicle

16.1 The Government initiated a debate on the structure of the local government pension schemes suggesting that there were too many funds and that amalgamation would save costs, lead to wider investment opportunities and possibly improve returns through better governance. In response to these proposals, London Council's through the Leaders Committee and Society of London Treasurers agreed to set up a vehicle for collective investment management. Haringey supported this initiative by contributing £25,000 towards the set up / investigation costs and purchasing £1 share capital. Almost all London council's have similarly agreed to initially support the establishment of the Collective Investment vehicle (CIV). It is anticipated that the establishment formalities will be completed Q1, 2015 at which point Haringey will have the opportunity to invest some of its fund through the CIV on a voluntary basis.

16.2 The government has reflected on the responses for the call for evidence on LGPS structures and has issued a consultation document, which is a separate paper on the agenda.

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Appendix 1

Strategic Asset Allocation

Asset class	Benchmark %		Range %
UK Equities		15	12-18%
Overseas Equities		45	40-50%
North America	21.7		
Europe ex UK	7.4		
Pacific ex Japan	3.4		
Japan	3.5		
Emerging Markets	9		
UK Index linked gilts		15	12-18%
Property		10	6-12%
Multi Sector Credit		5	4-6%
Infrastructure Debt		5	4-6%
Private Equity		5	4-6%
Cash		0	0-10%

Agenda Item 8

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Report for:	Pensions Committee 23rd June 2014	**Item number**	

Title:	Pension Fund – Work Plan 2014-15

Report authorised by :	Assistant Director – Finance (CFO)

Lead Officer:	George Bruce, Head of Finance – Treasury & Pensions George.bruce@haringey.gov.uk 020 8489 8621

Ward(s) affected: N/A	**Report for** Non Key Decision

1. Describe the issue under consideration

1.1 The purpose of the paper is to identify topics that will come to the attention of the Committee in the year to March 2015 and seek Members input into futures agenda's.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 The Committee is invited to identify additional issues for inclusion within the work plan.

4. Other options considered

4.1 None.

5. Background information

5.1 It is best practice for a Pension Fund to prepare a work plan. This plan sets out the key activities anticipated in the coming municipal year in the areas of governance, members / employers, investment and accounting.

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6. Comments of the Chief Finance Officer & financial implications

6.1 There are no financial implications arising from this report.

7. Assistant Director of Corporate Governance comments and Legal Implications

7.1 The Council as administering authority for the Haringey Pension Fund has the power to invest fund monies as set out in Local Government Pension Scheme (Management and Investment Funds) Regulations 2009.

7.2 There are no specific legal implications arising from this report

8. Equalities and Community Cohesion Comments

8.1 Not applicable.

9. Head of Procurement Comments

9.1 Not applicable.

10. Policy Implications

10.1 None.

11. Use of Appendices

None

12 Local Government (Access to Information) Act 1985

12.1 Not applicable.

13. Governance Issues

Terms of Reference

13.1 The terms of reference of the committee are included within the meeting papers. Through its role in “Exercising all the Council’s functions as “Administrating Authority”” the committee has the responsibility for the governance of the Local Government Pension Scheme in Haringey. A significant amount of the Committee’s time will be devoted to investment matters although it should be noted that employer and member issues fall within the remit of the Committee. Given, however the increased emphasis on governance under the Public Service Pensions Act 2013 (see sections 13.5 to 13.8 of this report) it is anticipated that this, as well as investment issues, will form a significant element of the Committee’s activity.

13.2 The terms of reference should be kept under review and revised both to reflect changes in regulation but also the Committee’s appraisal of its role.

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Member Training

13.3 Pension's is a specialist area involving the use of terminology that may be unfamiliar to new committee members. Training on all aspects of pensions is vital before Members are asked to consider technical issues.

13.4 An introduction to pensions session, presented by officers and the independent advisor, was held on 19th June. It is proposed that a follow up session is held in July at which the independent advisor, actuary and investment consultant will outline the background to the investment strategy and the link between the strategy and the pension liabilities. It is also suggested that a rolling programme of training is provided prior to each Committee meeting on both general topics and issues specific to the meeting agenda. This training will mainly be provided by the independent advisor and officers, with involvement from advisors, fund managers and the custodian. This programme of training cover areas of knowledge and skills identified in the CIPFA Pensions Knowledge and Skills Framework plus such other issues as are desirable for members of the Pensions Committee to have an understanding of.

Regulations

13.5 The Public Service Pensions Act 2013 will be fully implemented By April 2015. This will drastically change the governance framework under which pensions matters are managed and monitored.

13.6 Due to the significance of the proposed changes, a consultation on their implications will commence mid June with final regulations in place by September 2014.

13.7 In addition to the regulations, the Pension Regulator, who has been given additional oversight responsibilities for LGPS administrative (but not investment) issues, will issue best practice guidance this summer relating to the controls and reporting that should be in place.

13.8 It is anticipated that a large proportion of the Committee's time in the next 6-9 months will be devoted to considering the options around the implementation of the regulations and code of practice.

Member and Employer Issues

14. Member and Employer Issues

14.1 A revised schedule of contributions for each employer has been implemented from 1st April 2014. In most cases this comprises two elements; a rate linked to earnings and also a deficit lump sum. Officers will need to closely monitor that employers are paying the correct rate.

14.2 The revised benefit structure involved in the move from a final salary scheme to a career average pension will increase the complexity of the pension

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administration function. This will potentially increase the emphasis that, over time, the committee, will need to give to pension administrative issues.

15. Investment Strategy and Fund Managers

15.1 A detailed strategy review was completed in 2013-14 and it is not planned to repeat this exercise in the next twelve months, although the continued appropriateness of the strategy should be monitored. Material changes in the value of the assets, the pension liabilities, prevailing investment returns or interest rates will all impact on the continued appropriateness of the strategy.

15.2 Three aspects of the implementation of the revised strategy are currently in progress:

- The appointment and funding of the new multi-sector credit (CQS) and infrastructure debt (Allianz) mandates.
- The increased funding to bring the property portfolio to 10% of the overall fund.

15.3 The main item carried forward from the strategy review is the required level of inflation protection and whether this can be enhanced through the use of leverage index linked funds.

15.4 Other matters arising from the strategy that will feature on future agenda's are:

- The make up of the passive equity portfolio, in particular alternatives to market capitalisation based benchmarks.
- Additional commitments to private equity to maintain the 5% allocation.

15.5 The investment strategy is designed to generate an improvement in the funding level (bring assets into line with the value of pension liabilities). Over the last year, the funding level has improved by 3% to 73%. Improvements in the funding level offer the opportunity to take less investment risk through increasing the linkage between changes in the value of investments and pension liabilities. When these changes take place and how they will be implemented should be documented to ensure that opportunities to lock in favourable movements are not missed. It is intended to develop a long term investment plan linked to liabilities during the next year.

16. Collective Investment Vehicle

16.1 The London Collective Investment Vehicle (CIV) is expected to be operational in Q1, 2015. Its role is to act on behalf of London LGPS to appoint and monitor fund managers, thereby generating fee savings, improving investment performance and increasing investment opportunities. Passive equity will be the first asset class for the CIV. Participation is voluntary and the Committee will be asked whether it wishes to switch the current BlackRock and Legal and General mandates to the CIV. Much will depend on the fee rates that the CIV is able to negotiate.

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17 Routine Business

17.1 Other issues that will feature on agenda's include:

- Updates to statutory documents; the Statement of Investment Principles, Funding Strategy Statement, Governance Compliance Statement and Communications Policy. Other policy documents, such as disputes resolution procedures should also be reviewed.
- The approach to responsible investment and ESG issues.
- The setting and monitoring of budgets.
- The review of the fund's annual financial statements.

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Report for:	**Pensions Committee** 20 June 2014	**Item number**	

Title:	**Pension Fund Quarterly Update**

Report authorised by :	**Assistant Director – Finance (CFO)**

Lead Officer:	George Bruce, Head of Finance – Treasury & Pensions george.bruce@haringey.gov.uk 020 8489 3726

Ward(s) affected: N/A	**Report for** Non Key Decision

1. Describe the issue under consideration

1.1 To report the following in respect of the three months to 31st March 2014:

- Investment asset allocation
- Investment performance
- Responsible investment activity
- Budget management
- Late payment of contributions
- Communications

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 That the information provided in respect of the activity in the three months to 31st March 2014 is noted.

4. Other options considered

4.1 None.

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5. Background information

5.1 This update report is produced on a quarterly basis. The Local Government Pension Scheme Regulations require the Committee to review investment performance on a quarterly basis and sections 13 and 14 provide the information for this. Appendix 1 shows the targets which have been agreed with the fund managers.

5.2 The Pension Fund has a responsible investment policy and section 15 of this report monitors action taken in line with it. The remainder of the report covers various issues on which the Committee or its predecessor body have requested they receive regular updates.

5.3 Information on communication with stakeholders has been provided by officers in Human Resources and included in section 18.

6. Comments of the Chief Financial Officer and Financial Implications

6.1 The investment performance figures in section 14 show the impact of the introduction of passive fund managers in that generally the variance from target has reduced. The negative performance over three and five years reflects the underperformance of the private equity portfolio that has a demanding public equity plus benchmark. Over longer time periods, the fund has achieved a return in excess of the average local authority.

7. Head of Legal Services and Legal Implications

7.1 The Council as administering authority for the Haringey Pension Fund ("Fund") has an obligation to keep the performance of its investment managers under review. In this respect the Council must, at least every three months review the investments made by investment managers for the Fund and any other actions taken by them in relation to it;

7.2 Periodically the Council must consider whether or not to retain the investment managers. In particular members should note the continuing negative performance compared with the target benchmarks and the reason stated in this report as to why this is the case;

7.3 In carrying out its review proper advice must be obtained about the variety of investments that have been made and the suitability and types of investment;

7.4 All monies must be invested in accordance with the Council's investment policy and members of the Committee should keep this duty in mind when considering this report and have regard to advice given to them.

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8. Equalities and Community Cohesion Comments

8.1 The Local Government Pension Scheme is a defined benefit open scheme enabling all employees of the Local Authority to participate. There are no impacts in terms of equality from the recommendations contained within this report.

9. Head of Procurement Comments

9.1 Not applicable

10. Policy Implications

10.1 None.

11. Use of Appendices

11.1 Appendix 1: Investment Managers' mandates, benchmarks and targets.

12. Local Government (Access to Information) Act 1985

12.1 Not applicable

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13. Investment Update

13.1 Fund Holdings at 31st March 2014

Total Portfolio Allocation by Manager & Asset Class

31/03/2014 & 30/04/2014

	Value 31.12.13 £'000	Value 31.03.14 £'000	Value 30.04.14 £'000	Allocation 30.04.2014 %	Strategic Allocation %
Equities					
UK	176,383	173,136	176,875	19.7%	17.5%
North America	255,655	257,969	256,652	28.6%	25.3%
Europe	82,680	78,487	78,764	8.8%	8.6%
Japan	35,741	29,449	28,329	3.1%	4.1%
Asia Pacific	35,762	34,644	34,931	3.9%	4.0%
Emerging Markets	89,426	88,730	87,955	9.8%	10.5%
Total Equities	**675,647**	**662,415**	**663,506**	**73.9%**	**70.0%**
Bonds					
Index Linked	**117,958**	**122,199**	**123,397**	**13.8%**	**15.0%**
Property					
CBRE	**56,691**	**68,473**	**73,188**	**8.1%**	**10.0%**
Private equity					
Pantheon	**34,527**	**35,333**	**34,698**	**3.9%**	**5.0%**
Cash & NCA	**5,883**	**9,204**	**3,253**	**0.3%**	**0.0%**
Total Assets	890,706	897,624	898,042	100.0%	100.0%
Fund Managers					
Legal & General	244,638	248,964	248,106	**27.6%**	**29.3%**
BlackRock	520,281	535,650	538,797	**60.0%**	**55.7%**

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The value of the fund increased by £6.9 million between December 2013 and March 2014. Equities gains were the main contributor to the market movements.

The recovery in equity markets in the last two years has seen the equity weighting rise to over 75%, in excess of its previous strategic weighting (70%). The other asset classes, mainly property remain, underweight. The January 2014 Corporate Committee meeting agreed to rebalance property back to its strategic allocation of 10%, which will involve additional property investments of approximately £35 million funded from sales of equities. As at March 2014 an additional £19.2 million of property had been purchased.

14. Investment Performance Update: to 31ST March 2014

Appendix 1 provides details of the benchmarks and targets the fund managers have been set. The tables below show the performance in the quarter January to March 2014.

14.1 Whole Fund

	Return	Benchmark	(Under)/Out	WM LA average
Jan-Mar 2014	1.15%	1.18%	(0.03%)	0.9%
One Year	5.03%	5.38%	(0.35%)	6.4%
Three Years	7.82%	8.23%	(0.41%)	7.5%
Five Years	12.81%	13.69%	(0.88%)	12.7%

One year	Return	Benchmark	Under/out	WM LA Average
Equities				
UK	8.89	8.81	0.08	11.3
Developed Europe	18.05	18.28	-0.23	15.1
North America	10.19	10.3	-0.11	11.9
Japan	-2.02	-1.56	-0.46	0.5
Asia ex Japan	-6.56	-6.59	0.03	-7.1
Emerging	-10.87	-10.79	-0.08	-5.1
I L gilts	-4.48	-4.45	-0.03	-4.4
Property	12.50	12.04	0.46	11.0
Private equity	8.04	14.45	-6.41	5.4
Total	**5.03**	**5.38**	**-0.35**	**6.4**

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Five years	Return	Benchmark	Under/out	WM LA Average
Equities				
UK	16.19	16.36	-0.17	17.5
Developed Europe	14.09	14.54	-0.45	15.0
North America	17.18	17.15	0.03	17.2
Japan	9.45	7.16	2.29	9.3
Asia ex Japan	14.99	15.56	-0.57	14.9
Emerging	12.82	11.21	1.61	12.6
Index linked gilts	9.55	8.78	0.77	8.6
Property	6.51	8.04	-1.50	7.7
Private equity	4.20	21.11	-16.91	6.0
Total	**12.81**	**13.69**	**-0.88**	**12.7**

- All four time periods indicate under performance compared with the benchmarks, more so in the longer 3 and 5 year periods.
- Equity and index linked gilts, which are passively managed, show some variability compared to the benchmarks, but not significant differences.
- The main detractor from performance is private equity and in the five year period, property. Private equity has a public equity plus 5% target, which it has not achieved.
- Compared with the average local authority, the fund has exceeded the average return over the quarter, three and five years. For the one year period, the total return is less than the average local authority due to the relative returns from UK equities.
- The funds higher than average allocation to equities and lower than average allocation to fixed income and alternatives have compensated for lower asset class returns over five years.

14.2 BlackRock Investment Management

	Return	Benchmark	(Under)/Out
Jan-Mar 2014	1.07%	1.26%	(0.19%)
One Year	6.68%	6.51%	0.17%

- Total Value at 31/03/14: £535.6 million
- BlackRock manages equities and index linked passively.
- Further details of returns at geographic level are given in section 14.7, which indicates underperformance against the Japanese index, which is being investigated.

14.3 Legal & General Investment Management

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	Return	Benchmark	Variance
Jan-Mar 2014	0.06%	0.12%	(0.06%)
One Year	(0.38%)	(0.41%)	0.03%

- Total Value at 31/03/14: £248.9 million
- Variances as regional level are minimal.

14.4 CBRE Global Investors

	Return	Benchmark	(Under)/Out
Jan-Mar 2014	4.42%	3.30%	1.12%
One Year	12.50%	12.04%	0.46%
Three Years	5.50%	6.53%	(1.03%)
Five Years	6.51%	8.04%	(1.53%)

- Total Value at 31/03/14: £68.5 million
- Although performance in the quarter and year exceeded benchmark longer term terms have fallen below benchmark. The target is to out perform by 1% p.a.
- Recently, the UK portfolio has exceeded benchmark, but the overall portfolio has suffered from exposure to Italian and German funds.

14.5 Pantheon

	Return	Distributions in period	Drawdowns in period	% drawdown
Jan-Mar 2014	4.83%	£1.08m	£0.20m	
One Year	8.04%	£3.94m	£1.93m	
Since inception	4.51%	£8.51m	£33.00m	69.4%

- Total Value at 31/03/14: £35.3 million
- Distributions exceeded drawdowns during the quarter as the funds moved into the distribution phase of their cycles.
- The performance target is the MCSI Worlds plus 5%, which for 12 months is 14.45% and 3 years 14.85%. Actual returns for three ears net of fees is 8.8%. The funds are still relatively young for a true picture of long term returns to emerge. It is only when the fund is substantially realised will a true picture of performance emerge. The performance benchmark (MSCI plus 5% net of fees) is challenging.

14.6 In house cash

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	Value	Average Credit Rating	Average Maturity (days)	Return
At 31/03/14	£1.74m	AAA	1	0.25%
At 31/12/13	£0.92m	AAA	1	0.22%
At 30/09/13	£2.73m	AAA	1	0.33%
At 30/06/13	£3.18m	AAA	1	0.33%

14.7 Equity Market Performance

	3 months			12 months			Allocations	
	Return	**Benchmark**	**Difference**	**Return**	**Benchmark**	**Difference**	**Actual**	**Target**
Legal & General								
UK Equity	-0.60	-0.63	0.03	8.96	8.81	0.15	9.28%	8.87%
North Amer equity	1.19	1.19	0.00	10.29	10.30	-0.01	12.81%	12.97%
Europe equity	2.98	3.03	-0.05	18.02	18.28	-0.26	15.46%	14.67%
Asia Pac equity	0.94	1.00	-0.06	-6.62	-6.59	-0.03	6.69%	6.83%
Japan equity	-5.85	-5.99	0.14	-1.38	-1.56	0.18	10.50%	10.58%
Emerging equity	-0.78	-0.75	-0.03	-10.88	-10.79	-0.09	36.01%	35.84%
Index linked	3.58	3.56	0.02	-4.38	-4.45	0.07	9.25%	10.24%
total	0.06	0.12	-0.06	-0.38	-0.41	0.03	100.00%	100.00%
BlackRock								
UK Equity	-0.62	-0.63	0.01	9.01	8.81	0.20	28.13%	26.75%
North Amer equity	1.18	1.19	-0.01	10.04	10.30	-0.26	41.07%	38.60%
Europe equity	3.02	3.03	-0.01	18.15	18.28	-0.13	8.10%	7.72%
Asia Pac equity	0.72	1.00	-0.28	-6.50	-6.59	0.09	3.51%	3.57%
Japan equity	-5.96	-5.99	0.03	-2.89	-1.56	-1.33	1.76%	1.80%
Emerging equity	3.59	3.56	0.03	-4.37	-4.45	0.08	7.43%	21.56%
Index linked								
total	1.07	1.26	-0.19	6.68	6.51	0.17	100.00%	100.00%

The above table breaks down the performance of L&G and BlackRock at regional level. Returns are generally close to benchmark. The relative return for BlackRock's Japanese equity portfolio is being investigated.

15. Responsible Investment Activity in the three months ended 31st March 2014

BlackRock	Legal & General	LAPFF
15.1 Environmental Issues		
	Together with other institutional investors, we engaged with a number of companies in the consumer brand and extractive sectors, to understand how tax risks are being managed in companies which face increasing pressures from consumers and regulations. We have put together a discussion paper on this complicated subject, which we intend to share with other investors and help develop the dialogue on the expectation of future disclosure from companies.	The LAPFF March 2014 engagement report has not been received.

BlackRock	Legal & General	LAPFF
15.2 Governance / Remuneration Issues		
We engaged with several issuers to discuss **governance** more broadly. Common areas discussed included corporate strategy and its link to sustainability, and risk evaluation including an assessment of key risks:	**Sports Direct** A meeting was held with the Chairman to discuss the proposed new incentive Plan for the Deputy Chairman (Founder and significant shareholder), which	

BlackRock	Legal & General	LAPFF
We examined board composition, skill set and director induction programmes in light of minor changes at sub-committee level. We engaged with the Chairman of a financial services company to discuss the functioning of the current board given recent appointments, the board composition and skill set, ongoing refreshment/succession planning for both executives and nonexecutives, and planned board evaluations. We also reviewed progress in getting the relationship with regulators back on track, key risks for the business, and strategy including a discussion on the US business. We attended a regular governance update for a major extractives industry issuer. We used this opportunity to discuss the company's sustainability programme and how it links to corporate strategy, time horizon, risk evaluation, alternative energies and future outlook of portfolio. As was the case in the previous quarter, we have continued to experience a substantial	would have delivered 8 million shares worth approximately £66 million, if certain targets were met over the next two years. We were keen to understand why the board was proposing an equity plan for the Deputy Chairman again when a similar plan had been rejected by shareholders in 2012. Days before the extraordinary general meeting (EGM) the plan was withdrawn due to lack of shareholder support. We will continue to engage with the company. **First Group** We met the new Chairman of the company to discuss his views and plans to turnaround the company following long-term poor operational performance and a large rights issue in 2013. We discussed a range of issues including the plans for underperforming business units, the balance sheet, the board, union relations and dividend policy. We will continue to engage with the company to enhance shareholder value.	

BlackRock	Legal & General	LAPFF
increase in the number of engagements with UK issuers on executive **remuneration** matters. During the quarter, we also noted an increase in the number of UK issuers wishing to merge their short- and long-term incentive schemes into a single incentive vehicle for their executive team. With the purpose of simplifying their remuneration practices, some boards have opted for annual performance measures. The long-term element is retained with a deferral mechanism spanning three to five years and subject to further performance conditions and/or underpin. Although highlighting certain concerns over long-term alignment risks, BlackRock has been broadly supportive of these new structures during its engagements.		

BlackRock	Legal & General	LAPFF
15.3 Other Engagement activity		
In a joint engagement with our portfolio	**JP Morgan**	

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BlackRock	Legal & General	LAPFF
management team, we met with a board member of a British retail group to discuss a performance-based equity award for the executive deputy chairman. We sought to understand the structure of the scheme and the board's rationale for the proposal. Although the executive deputy chairman did not receive any remuneration at the time, it was decided to vote against the plan at the extraordinary shareholder meeting based on the timing of the award and its size.	We met with an independent board member to further our engagement with the company. We discussed board structure, the risk management process, employee management, as well as financial regulation and the company's culture and emerging issues in this area. We shall continue to strengthen our discussions with the company.	

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16. Budget Management – 12 months to 31st March 2014

	Prior year 2012-13 £'000	Current year 2013-14 £'000	Change in expenditure £'000
Contributions & Benefit related expenditure			
Income			
Employee Contributions	8,800	8,554	246
Employer Contributions	32,000	30,461	1,539
Transfer Values in	4,000	2,434	1,566
Total Income	44,800	41,449	3,351
Expenditure			
Pensions & Benefits	(40,000)	(40,417)	417
Transfer Values Paid	(5,200)	(3,277)	(1,923)
Administrative Expenses	(800)	(801)	1
Total Expenditure	(46,000)	(44,495))	(1,505)
Net of Contributions & Benefits	(1,200)	(3,046)	1,846
Returns on investment			
Net Investment Income	3,600	2,578	1,022
Investment Management Expenses	(1,600)	(1,658)	58
Net Return on Investment	2,000	920	1,080
Total	**800**	**(2,126)**	**2,926**

The fund has moved into a position in which expenditure exceeds income as active membership fall and numbers of pensioners' increases. Member and employer contribution increases in 2014-15 will mitigate this tread.

The income shown for 2013-14 is virtually all from property as income from other asset classes is automatically re-invested and shown within the change in market value. The fall in income is due to equity income now being included in the change in value of investments.

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17. Late Payment of Contributions

17.1 The table below provides details of the employers who have made late payments during the last quarter. These employers have been contacted and reminded of their obligations to remit contributions on time.

Employer	Occasions late	Average Number of days late	Average monthly contributions(£)
Mulberry	1	19	14,500
Lordship Lane	1	3	13,700
Hartsbrook	1	2	3,200
TLC	2	4	4,183

18. Communication Policy

18.1 Two sets of regulations govern pension communications in the LGPS: The Disclosure of Information Regulations 1996 (as amended) and Regulation 67 of the Local Government Pensions Scheme (Administration) Regulations 2008 as amended.

18.2 In March 2011, the Council approved the Pensions Administration Strategy Statement (PASS). The PASS sets out time scales and procedures which are compliant with the requirements of the Disclosure of Information Regulations. The PASS is a framework within which the Council as the Administering Authority for the Fund can work together with its employing bodies to ensure that the necessary statutory requirements are being met.

18.3 In June 2008 the Council approved the Policy Statement on Communications with scheme members and employing bodies. The Policy Statement identifies the means by which the Council communicates with the Fund members, the employing bodies, elected members, and other stakeholders. These cover a wide range of activities which include meetings, workshops, individual correspondence and use of the internet. In recent times, the Pensions web page has been developed to provide a wide range of employee guides, forms and policy documents. Where possible, Newsletters and individual notices are sent by email to reduce printing and postage costs.

18.4 The requirement to publish a Communications Policy Statement recognises the importance that transparent effective communication has on the proper management of the LGPS.

18.5 During the third quarter of 2013-14, one of the Council's AVC providers Prudential gave a presentation to staff on the services they offer. In December the Council met with the other employer bodies participating in the

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Fund, to share information on the 2014 actuarial valuation exercise and to provide a brief outline on the new scheme to be introduced from April 2014.

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Appendix 1 – Investment Managers mandates, benchmarks and targets

Manager	**% of Total Portfolio**	**Mandate**	**Benchmark**	**Performance Target**
BlackRock Investment Management	55.7%	Global Equities & Bonds	See overleaf	Index (passively managed)
Legal & General Investment Management	29.3%	Global Equities & Bonds	See overleaf	Index (passively managed)
CBRE Global Investors	10%	Property	IPD UK Pooled Property Funds All Balanced Index	+1% gross of fees p.a. over a rolling 5 yr period
Pantheon Private Equity	5%	Private Equity	MSCI World Index plus 5%	+ 0.75% gross of fees p.a.
Total	**100%**			

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Asset Class	Benchmark	BlackRock Investment Management	Legal & General Investment Management	Total
UK Equities	FTSE All Share	14.9%	2.6%	17.5%
Overseas Equities		28.8%	23.7%	52.5%
North America	FT World Developed North America GBP Unhedged	*21.5%*	*3.8%*	*25.3%*
Europe ex UK	FT World Developed Europe X UK GBP Unhedged	*4.3%*	*4.3%*	*8.6%*
Pacific ex Japan	FT World Developed Pacific X Japan GBP Unhedged	*2.0%*	*2.0%*	*4.0%*
Japan	FT World Developed Japan GBP Unhedged	*1.0%*	*3.1%*	*4.1%*
Emerging Markets	FT World Global Emerging Markets GBP Unhedged	*0.0%*	*10.5%*	*10.5%*
Index Linked Gilts	FTA Index Linked Over 5 Years Index	12.0%	3.0%	15.0%
		55.7%	29.3%	85.0%

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Agenda Item 10

Haringey Council

Report for:	Pensions Committee 23rd June 2014	**Item number**	

Title:	Pension Fund Consultation

Report authorised by :	Assistant Director – Finance (CFO)

Lead Officer:	George Bruce Head of Finance – Treasury & Pensions George.bruce@haringey.gov.uk 020 8489 3726

Ward(s) affected: N/A	**Report for** Non Key Decision

1. Describe the issue under consideration

1.1 The DCLG has issued a consultation document "Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies". A proposed response is attached for consideration.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 That members approve the proposed response to DCLG attached to this report and authorise the Assistant Director – Finance to send the response to DCLG on behalf of the Committee.

4. Other options considered

4.1 None.

5. Background information

5.1 The Government launched a call for Evidence on the structure of LGPS in summer 2013 starting a debate on the structure of the LGPS

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and in particular whether merger into a smaller number of funds was appropriate.

5.2 This consultation document follows on from the call for evidence and proposes that the current LGPS structure is maintained, with individual local authorities remaining responsible for their own pension fund and directing the investment strategy for their fund. This is in line with Haringey's response to the call for evidence.

5.3 The changes proposed within the consultation document cover two main areas:

a) That local authorities share investment management through the establishment of collective investment vehicles ("CIV's"), and

b) Greater use is made of passive management to reduce costs and avoid underperformance relative to benchmarks.

5.4 Haringey has demonstrated its support for the first initiative by contributing to the establishment costs of the London CIV, expected to be operational in Q1, 2015.

5.5 Most of the pension fund's assets are managed passively, which is in line with (b) above. However, we do point out in our response that:

- Saving fees will not by itself materially reduce deficits and contribution levels,
- The use of CIV's should be voluntary and there should be choice and competition between a small number of CIV's
- Some asset classes can or should not be managed passively,
- Investors who can demonstrate skills in active management should not be prevented from investing actively.

5.6 A draft response is attached, which has been discussed with the independent advisor. Overall, the response is supportive of the Government's proposals, although suggesting that they do not tackle the main issues of deficits and high contribution rates. Of the four options relating to the use of passive and active investment techniques we propose "comply or explain" on a rigorous partly independently verified basis so as to ensure active management is only undertaken when its use and likely success can be justified.

5.7 The deadline for responding is 11 July 2014.

6. Comments of the Chief Financial Officer and financial Implications

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6.1 The proposals are part of a process of tightening up oversight and governance standards in LGPS and examining opportunities to reduce the burden of costs to support the scheme. The proposals will not alter the fundamental role of the Council in administering the Haringey fund or setting an investment strategy. They will offer additional investment implementation opportunities if offered on a voluntary basis that could save costs.

7. Assistant Director of Corporate Governance comments and Legal Implications

7.1 The Assistant Director of Corporate Governance has been consulted on the contents of this report. The response is part of a consultation process being undertaken by the DCLG.

8. Equalities and Community Cohesion Comments

8.1 There are no equalities issues arising from this report.

9. Head of Procurement Comments

9.1 Not applicable

10. Policy Implications

10.1 None.

11. Use of Appendices

11.1 Appendix 1: Consultation document.
Appendix 2: draft response to the consultation.

12. Local Government (Access to Information) Act 1985

12.1 Not applicable.

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Department for Communities and Local Government

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

Consultation

May 2014
Department for Communities and Local Government

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Contents

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

	Department for Communities and Local Government Zone 5/F5, Eland House Bressenden Place London, SW1E 5DU 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.
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:	This consultation has been developed drawing on three sources of evidence: • 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. 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.
Previous engagement:	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. The call for evidence also drew on a round table event that took place on 16 May 2013 with representatives of administering

	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.

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 stated[8]:

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

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[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.

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[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 role[16].

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

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 achieve 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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Dear Ms Edwards

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

The London Borough of Haringey Local Government Pension Fund welcomes the opportunity to respond to consultation on the future structure of the LGPS.

We are highly supportive of the consultation and of the questions being asked. The debate on structure of the LGPS has been intensive and has already generated significant structural change through moves to establish a London CIV. The London Borough of Haringey is committed to the principle and benefits of co-operative working between local government pension funds. For example during 2013 the Haringey Fund has utilised the National LGPS Frameworks to procure both Actuarial and Investment Consultancy services. The Fund has part financed the establishment of a London-wide Collective Investment Vehicle (CIV). We welcome the positive attitude of the DCLG to the responses to the Call for Evidence and the Hyman's Robertson report. We also consider the broad thrust towards collective working on a voluntary basis to be appropriate.

However, to believe that the issues around deficits and high contribution rates will be wholly solved by better management of costs is misguided. As shown by an examination of the 2013 Actuarial Valuation reports for over 80 of the LGPS Funds in England and Wales most Funds Investments returns net of costs during the period 2010 to 2013 exceeded the actuarial projections made in the 2010 Valuations. The increase in deficits is due to the recognition of improvements in longevity and lower bond yields, mainly due to the current economic conditions and quantitative easing. Indeed an examination of the more than 80 of the 2013 Actuarial Valuation reports on the Shadow Board website shows that if the effect of lower bond yields between 2010 and 2013 is removed the funding position of LGPS Funds improved during this period. The recent increase in the numerical deficits of LGPS Funds has nothing to do with a failure by LGPS Funds to achieve good investment returns.

The Government has taken some limited action in the 2014 reforms to make the benefit structure more affordable longer term although this does not address the pre 2014 pension liabilities for which Local Authorities will have to bear the costs of a benefit structure that was unsustainable.

In response to each of the questions in the consultation document evidence the London Borough of Haringey Local Government Pension Fund wishes make the following comments:

Question 1- 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 review.

Yes overall we do. We refer you to our response to last year's Call for Evidence in which we stated:

"Co-operative working between Funds may clearly assist in achieving the high level objectives of dealing with deficits and improving investment returns. Co-operative working will potentially facilitate the sharing of ideas and the joint procurement/provision of services while not undermining the local accountability which is such a positive feature of the existing 89 Fund approach.

For example a Collective Investment Vehicle (CIV) such as that currently under active consideration by the London Funds (with the active participation of the London Borough of Haringey which has [contributed] £25,000 towards costs in connection with the establishment of a London wide CIV) will facilitate the identification of "best of breed" managers across different asset classes and enable these to be accessed at potentially lower fees through the buying power of the CIV. A voluntary approach that has the same potential to impact on management fees, governance capabilities and selection of high quality investment managers, yet avoids the disruption and costs of restructure and maintains local involvement, must be preferable to compulsory mergers."

This remains our opinion. We know from the fee structures in place for our existing mandates that the fee scale reduces as the size of the mandate increases. While savings are readily achievable for 'standard' products e.g. developed equities, government bonds etc, for alternative assets, there is the added challenge of the sheer variety of such mandates and how a CIV would streamline these to achieve volume discounts.

Of course, saving fees should not come at the cost of lower investment returns and a CIV, particularly one managing active and alternative mandates must have appropriately skilled resources.

Participation in any particular CIV should however be voluntary. CIVs need to demonstrate that they can improve returns for individual Funds through lower fees for passive strategies and both lower fees and "superior" manager selection for active strategies. It cannot simply be assumed that in all cases procurement through a CIV will be more advantageous than procurement by an individual Fund. There should not be compulsion on a Fund to use a CIV. Funds should be required to positively consider the use of a CIV and explain in a report to their Pension Committee why or why not a CIV was used to implement any particular strategy.

There should be more than one CIV as there are so many different approaches that a Fund may wish to follow in terms of implementing its Strategic Asset Allocation that no one CIV could meet the needs of all 89 Funds. To take passive equity investment as a simple example there is not one but many potential indices that a Fund may wish to utilise and any one CIV may not provide access to products utilising the type of approach that an individual Fund wishes to enact its Strategic Asset Allocation. The development of a number of CIVs (see also answer to Question 3) will increase the range of approaches/products offered through CIVs meaning that Funds are more likely to achieve improved returns (net of fees) through the voluntary use of a CIV rather than through individual procurement.

Question 2- Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

Yes. Again, we fully explained this in our response to the Call for Evidence.

“The existing Funds provide the basis for a high level of accountability to local taxpayers and other interested parties by virtue of the fact that they are (almost) all administered by a major local authority usually a London Borough or County Council or in Wales a lead unitary Council or in the case of the former Metropolitan County Council schemes a lead Metropolitan Borough. This arrangement provides democratically based accountability to all stakeholders.

There are very many employers within the local government pension scheme who are not Administering Authorities. These employers who are very important “interested parties” are diverse in their nature and the present 89 Fund arrangement allows for each employer to be a member of a Fund which is fairly local to them. The current arrangements also allow for a reasonable level of representation by such employers on the governing committee and any sub committees or working groups established by the Administering Authority.

Improved accountability is of course desirable and this should clearly be assisted and improved by the new governance arrangements to be introduced as a result of the Public Service Pensions Act 2013.

Given that local accountability is clearly embedded to the current structure of the LGPS any alternative proposal in terms of the amalgamation of Funds or the creation of “super funds” would result in the loss of local decision making and accountability on issues of interest to local taxpayers and other stakeholders including deficit recovery plans and employer contribution rates. In London taxpayers are provided with the vast majority of their local government services by a London Borough which also in its role as an Administering Authority runs the LGPS in that borough area. This arrangement which has been in place since 1965 is easy to understand. Taxpayers would doubtlessly find any alternative arrangement based on “super funds” in London less transparent and easy to understand. Any such reorganisation would run counter to the principle of localism.

As already stated the present structure of 89 Funds allows for fairly local governance, decision making and accountability. The number of employing bodies within the LGPS is clearly increasing and will continue to do so as a result of initiatives such as the conversion of schools to academies, the creation of Free Schools and the continuing trend towards outsourcing of local government services. The opportunity for employing bodies to be represented on Administering Authority decision making committees and groups is therefore becoming ever more important. This fact reinforces the desirability of maintaining the existing 89 Funds. Any reduction in the number of Funds will make it more difficult to meaningfully actively involve employers in the governance of the LGPS and make it genuinely accountable to them.”

Local accountability will however be diminished by any compulsory requirement on Funds to use a CIV to procure asset managers. As indicated elsewhere in this response a well developed CIV approach will result in Funds looking to CIVs to procure asset managers rather than seeking to procure themselves. However local accountability, and value for money, is supported by an approach where an individual Fund gives careful and transparent consideration to differing procurement approaches before making a final decision as to approach to be utilised.

Question 3- 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?

Assuming that the first part of the question relates to management structures i.e. a London CIV with multi sub funds is one CIV, then more than one should be available to each Local Authority. Possibly a choice of three or four will offer a good balance of choice and scale. Competition amongst CIV's is important. Talk of regional CIV, e.g. one for London, will lead to monopolies, which are rarely run for the benefit of consumers. We prefer to see Local Authorities given an option of which CIV to use. The advantages of more than one is that there will be competition to

1. Keep the CIV's own costs low and encourage democratic governance. Also funds can select what they believe to be the strongest CIV.
2. Encourage the CIV to negotiate the lowest costs with fund managers.
3. Enable CIV's to develop asset class strategies in discussion with individual funds, such that there is choice but not unnecessary proliferation. For example some investors may wish alternatives forms of passive – equal weighted or value weighted. Not all CIV's might wish to offer this option, but if there is a choice, one may do so.

Groups of Local Authorities should be able to set up additional CIV's that may better suit their own particular requirements.

The number of asset classes should evolve in discussion between each CIV and individual funds. There will be potentially many strategies / pools for each asset class e.g. for passive equities – global market cap, regional market cap, regional small cap, emerging, frontier, alternative passive etc. The starting point should be to identify current benchmarks in use and try and consolidate into a manageable number that doesn't unreasonably restrict choice. Over time additional choices will emerge provided that Local Authorities have the ability to shop around between CIV's.

Question 4- What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

Not being experts in pooled fund structures we have restricted our response to desired characteristics of a CIV:

- It is as tax efficient as direct investment by a Local Authority Pension Scheme.

- Establishment and structural costs are minimised.
- Ownership and management control by investors.
- Liquidity is in line with the underlying instruments e.g. minimum monthly for listed asset classes.
- Avoidance of un-necessary transaction costs.
- Initially, the use of an experienced fund administrator to manage the accounting and investment / disinvestment functions.
- Transparency as to costs incurred.
- Participation by any individual LGPS Fund is voluntary.

The key driver of good governance will be the retention of choice to use or not use a CIV. Ideally, each CIV will be owned by Local Authorities, probably regional groupings. However, the election of directors who oversea the CIV should also involve those who invest through the CIV.

The day-to-day activities may be controlled by staff appointed by the 'directors' or out-sourced. What matters is that shareholders can monitor and influence these arrangements. CIV's should be responsive to the needs of local authorities and if not they should be not be preserved.

CIV's may well wish to expand their remit and take on additional functions e.g. those typically performed by investment consultants or fund managers. Their capabilities and skills need to be consistent with the roles performed.

Question 5- 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?

Haringey has recognised that both passive and active management have a place in our fund. Currently, all our equities and index linked bonds, which comprise 75% of our strategy, are passively managed, with the other 25% (property, credit and private equity) actively managed. We do not believe that all asset classes can be passively managed and that skilled investors can add value through changing allocations to assets classes within diversified mandates and selecting securities that can out-perform an index. Passive management is not possible where there is not an investable benchmark e.g. private equity and property. We would also have very serious concerns with passive management of credit outside perhaps UK government bonds held for liability matching purposes.

Our decision to use passive management for all our listed equities was due to the recognition that:

1. We had suffered from poor active performance despite taking professional advice and we could not guarantee that this would not continue.

2. Time spent discussing the appointment and monitoring of active managers was taking an inappropriately large share of the Pensions Committee available time.

3. The fee savings from passive management out-weighted the likely gains from active management.

While we believe that active management of equities, our largest asset class, is not currently appropriate for the Haringey fund, this may not be the case for all Local Authorities, particularly those with well resourced internal teams.

Although not directly relevant to Haringey, we do see dangers with Local Authorities who have strong beliefs in their abilities to appoint and monitor active fund managers that are not supported by a positive track record of fund manager selection. It is all too easy to pass responsibility for poor past performance to the fund manager or investment consultant, without acknowledging the failures in monitoring by administering authorities. We are however aware that there are London Boroughs who have active equity managers who have a long term record of outperforming their benchmark net of fees. It would therefore be against the interests of such Funds to require them to disengage from active equity management in favour of passive equity management.

Of the options listed, we believe a comply or explain approach is optimum. We have explained above why we believe passive is not appropriate to all circumstances. However for listed equities, we do believe that it is the best approach unless equities are managed by an internal team or there is clear evidence of long term successful outperformance of the benchmark net of fees by an individual Funds existing active equity manager, or clear evidence based on an in depth assessment that any proposed new active equity manager will outperform the benchmark net of fees over a five year timescale.

Under a comply or explain regime, it is important that guidance is given on the factors that should be addressed when explaining active management of asset classes that can be effectively invested on a passive basis. The explanation should include past performance history at an asset class level compared with an appropriate passive benchmark, illustrating the value added or lost though active management. Ideally, this will be externally verified and be over a prescribed time period e.g. five years, to avoid selective disclosures.

When discussing the skills of Members, officers and advisors as reasons to support active management, this should be highlighted by examining the contribution of fund manager appointments recently terminated. Skilled investors will terminate mandates before change in capability is reflected in below benchmark returns.

To make comply or explain robust, explanations should be scrutinised by the Scheme Advisory Board, who should publically comment when they see explanations that have no real substance.

This response has been discussed with and approved by the Pensions Committee of the London Borough of Haringey. I trust the above provides a positive and constructive response to the consultation document.

Yours sincerely,

Kevin Bartle
Assistant Director - Finance

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