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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