MEETING	**PENSIONS COMMITTEE**
DATE	**17 JUNE 2014**
TITLE	**WESTMINSTER GOVERNMENT (DCLG) CONSULTATION ON THE OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES IN THE LGPS**
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1. INTRODUCTION

1.1 Members of the Committee will be aware that the eight LGPS funds in Wales have been investigating options for savings and efficiencies. The results of project indicated that collaboration was the way forward and the intention was to produce a business case for this option. This was put on hold when it became clear that the Government would be producing a consultation document.

1.2 In May 2014 the Department for Communities and Local Government issued a consultation document on opportunities, cost savings and efficiencies for the LGPS in England and Wales. The Government believes that there is scope for significant savings, of £660 million per annum, to be achieved through reform of the LGPS.

1.4 The consultation is aimed at all parties with an interest in the LGPS and the closing date for responses is 11 July 2014. The responses will be analysed and a Government response published. Should any legislative changes be needed, a further consultation will follow.

2. SUMMARY OF THE PROPOSALS

2.1 The consultation paper sets out a package of proposals including:

- 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 identify the true cost of investment and drive further efficiencies in the Scheme.
- A proposal not to pursue fund mergers at this time.

2.2 In addition to reducing fund costs the consultation paper requests respondents to consider fund deficits and how funding levels could be improved.

3. PROPOSAL 1: COMMON INVESTMENT VEHICLES

3.1 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.

3.2 Evidence supplied by Hymans Robertson in their study for the Government shows that there were slightly higher returns over ten years if the funds were organized through one common investment vehicle for listed assets and a second for alternatives, rather than a greater number. This suggests that savings will be maximized by the creation of two vehicles: a single common investment vehicle for listed assets organized by asset class (e.g. UK equity, European equity, UK bonds and so on) and a second vehicle for alternative assets.

3.3 Concentrating the Scheme into two common investment vehicles may increase its exposure to risk. Capacity constraints may begin to apply if a fund became too large. However, the Government believes that the exposure to risk should be mitigated if the asset allocation remains as diversified as at present. The Hymans Robertson report noted that the 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 common investment vehicles?

3.4 The term collective or common investment vehicle can be used very broadly and take different forms. The Government is seeking views on the specific type of common investment vehicles to be used. 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?

4 PROPOSAL 2: PASSIVE FUND MANAGEMENT OF LISTED ASSETS

4.1 LGPS funds use both passive and active equity managers with active management used more extensively than passive with the aim of achieving returns in excess of the market. The report produced for the Government by Hymans Robertson 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.

4.2 Hymans Robertson reported that fees savings achievable from moving to passive management of listed assets would be £230 million per annum and that the one-off cost of transition from active to passive could be around £215 million which is similar to the savings achieved in one year.

4.3 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 annum. This would represent a significant saving for the funds, employers and local taxpayers.

4.4 Having considered this analysis the Government believes that funds should make greater use of the 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.

4.5 The Government wishes to explore how to secure value for money through use of passive management while not adversely affecting investment returns. There is a number of options to achieve this:

- Requirement to move all listed assets into passive management
- Requirement to invest a specified percentage of their listed assets
- Requirement to manage listed assets passively on a "comply or explain" basis
- Expectation to consider the benefits of passively managed listed assets

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 the best value for taxpayers, Scheme members and employers?

5. RESPONSE TO CONSULTATION

5.1 Following up on the work between the eight pension funds in Wales a joint response from the eight funds has been proposed based on the results of the collaboration project. In addition, Gwynedd Council, as administering authority, will also respond.

The Committee is asked to consider any views or issues that they wish to include in the response from Gwynedd Council.