AGENDA ITEM 4

FALKIRK COUNCIL

Subject: **LOCAL GOVERNMENT PENSION SCHEME - 2015 UPDATE**
Meeting: **PENSIONS COMMITTEE**
Date: **5 JUNE 2014**
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1. INTRODUCTION

1.1 This report updates the Pensions Committee on recent developments regarding the on-going reform of the Local Government Pension Scheme (LGPS).

2. BACKGROUND

2.1 The LGPS is being updated in April, 2015 to satisfy the requirements of the Public Sector Pensions Act 2013 ("the 2013 Act"). A Heads of Agreement on scheme design between COSLA, Unions and the Scottish Government was reached in December, 2013. A Heads of Agreement on governance requirements is still the subject of ongoing discussion.

3. REGULATORY DELAY

3.1 In order that LGPS (Scotland) 2015 can be implemented in full, several pieces of legislation need to be made by the Scottish Parliament. These will expand on the high level principles set out in the Heads of Agreement. Unfortunately, there has been some slippage on the part of the Scottish Public Pensions Agency in drafting the provisions. The delay is not yet material, however any further slippage may have consequences such as software houses having a shortened timeframe in which to develop their systems and passing resulting costs onto authorities. COSLA is aware of this issue and is pursuing it through appropriate channels.

4. GOVERNANCE

4.1 Committee members will recall that at a national level the 2013 Act requires that there must be a **Scheme Advisory Board** to provide advice and guidance regarding the effective administration and management of the scheme. Equally, at a local level, the Act requires that there must be a **Scheme Manager** (aka the Pensions Committee) to make scheme decisions and a **Pensions Board** to support the Scheme Manager. The Pensions Board must contain an equal number of Union and Member representatives.

4.2 At the national level, it is likely that the existing Scottish Local Government Pensions Advisory Group (SLOGPAG) will mutate into the **Scheme Advisory Board** for Scotland, the main difference being that the Scottish Government will become observers rather than voting members.

4.3 At the local level, Unions are understood to favour Pension Committees and Pensions Boards being combined. Other stakeholders are wary of this since it would mean Unions having an equal voice in setting investment strategy. This seems unlikely to be agreed as the cost of any failed investment strategy would continue to fall on employers, rather than Scheme members. A counter argument to this is that employees could face additional costs due to the fact that LGPS 2015 will contain a mechanism to limit employers costs.

4.4 It is understood that a compromise solution is being considered whereby Committee and Board will exist as separate entities, but will meet together to consider a joint agenda.

5. LGPS DEVELOPMENTS IN ENGLAND AND WALES

5.1 One of the recommendations of the Hutton report in 2011 was for the UK Government to investigate the options for greater collaborative working amongst LGPS Funds. By summer, 2013, this broadened out into a consultation on the future structure of the LGPS issued by the Department of Communities and Local Government (DCLG) – the so called "Call for Evidence".

5.2 To assist the call for evidence, DCLG commissioned a research paper from Hymans Robertson looking at the costs and benefits of various options, including a single fund or several large funds. The report concluded that significant savings could be made if Funds:

- invested collectively;
- made greater use of passive management; and
- moved away from all "fund of fund" structures.

5.3 The total investment cost for the 89 England and Wales Funds amounts to approximately £790m per year. If all these Funds moved to passive investment of equities and bonds and accessed these through a common investment vehicle, the savings are estimated to be £420m, being a combination of a £230m saving from fees and a £190m saving from transactions costs. It is suggested that these savings could be realised within 2 years.

5.4 It is also estimated that a further £240m savings could be achieved by ceasing to use "fund of fund" arrangements for alternative assets in favour of a common investment vehicle. These savings would take longer to manifest as Funds could potentially have to wait up to 10 years for existing arrangements, such as private equity investments, to unwind.

5.5 The Call for Evidence and Hymans Robertson research has prompted DCLG to issue a further consultation paper - "Opportunities for collaboration, cost savings and efficiencies." Respondents are asked to consider the extent to which compulsion should be used to force Funds to adopt a passive/collective investment strategy.

5.6 The consultation also seeks views on the following:

- whether asset allocation decision making should be left locally with Funds
- how many collective investment vehicles should be established
- what asset classes should be covered by the collective investment vehicles
- the governance arrangements for collective investment vehicles

5.7 In relation to pensions administration, the Government recognises that efficiency savings could be achieved through improved fund collaboration and greater use of automation. However, the savings are miniscule in comparison with those that could be realised from a change in investment practice. As such, DCLG has decided to allow LGPS 2014 to bed in before considering any change of pension administration arrangements.

6. CONCLUSION

6.1 The LGPS reform agenda continues to roll on apace and shows little sign of abating.

6.2 The delay on the part of the Scottish Public Pensions Agency in bringing forward scheme rules is regrettable. Implementation of the scheme must happen on 1st April, 2015, so any further slippage will simply reduce preparation time for Funds and their software providers.

6.3 Discussions surrounding the shape of new LGPS governance arrangements appear to be moving forward, with a proposal for joint Committee and Board meetings being considered as a compromise solution between Unions and Employers.

6.4 The recently launched LGPS consultation in England and Wales with its proposed change in investment practice could be "the next big thing" for local authority pension funds. The statutory underpinning of the LGPS and its long term time horizons mean that a strategy of passive investment can be contemplated. There could however be circumstances in which active management is still preferable (e.g. where a Fund requires income rather than capital growth or where there is a prolonged bear market). The consultation should be the opportunity for these types of issue to be debated.

6.5 Whilst there is no guarantee that the line of thinking being pursued in England and Wales will be repeated in Scotland, it is inevitable that any cost cutting measures implemented south of the border will be of interest in Scotland.

7. RECOMMENDATION

7.1 The Committee is asked to note the developments taking place towards the implementation of the LGPS (Scotland) 2015.

Chief Finance Officer

Date: 23 May 2014

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<u>LIST OF BACKGROUND PAPERS</u>

NIL