## Review of the Structure of the Scottish Local Government Pension Scheme

**CONSULTATION RESPONSE FORM**

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| **Instructions** Responses in this form should be drafted in conjunction with the accompanying consultation report. To respond, please complete the **respondent details** and as many of the **consultation questions** your organisation wishes to complete and return the form via email to the Pensions Institute at [consultation@pensions-intitute.org](mailto:consultation@pensions-intitute.org) no later than **Friday, 7 December 2018**.  This consultation is being conducted in electronic form only, so **responses must be emailed**; hard copy posted or delivered responses cannot be received. Any queries about the consultation should be addressed to Matthew Roy, Fellow, Pensions Institute at matthew.roy@pensions-institute.org. |

**RESPONDENT DETAILS**

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| **Name of responding organisation(s)** Please list the full name of each organisation participating in this response. | **Organisation type** Is your organisation an administering authority, employer, or employee group? Please record for each responding organisation. |
| East Lothian Council | Local Government |
| **Authors** Please list any people that wish to be recorded as authors of this response, including name, job title and organisation. | **Consent** Please confirm each author consents to their information being retained for analysing the consultation responses by writing ‘confirm’ by their name. |
| Paul Ritchie, HR Business Partner  Jim Lamond, Head of Council Resources | confirm  confirm |
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| **Date** Please date the response. | 7 December 2018 |

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| **Covering information** If you wish to include covering information with your response, please include the text here. The text can wrap onto additional pages if needed. |
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The consultation questions follow.

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| **CONSULTATION QUESTIONS** Question 1: Retain the current structure with 11 fundsThe text can wrap onto additional pages. |
| 1. Cost of investing:  * How well informed do you feel about the investment costs in your fund? What information do you rely on to specify and measure these? * How well does the current system manage investment costs? * How would you improve the measurement and management of investment costs in the current system?   Reasonably well informed as relevant information is reported through Annual Report; bi-annual finance performance briefing.  Fund liabilities are generally 85-90% funded suggesting prudently managed.  Fee levels important to funds. Understanding costs is an essential element of evaluating whether good value for money is being delivered.  Lothian PF have an in-house investment team which performs well and has led to significant savings on investment costs. They have also been collaborating with other funds and this has delivered further benefits although interestingly the Fund do not believe this is scalable based on existing structures.  We would always hope that investment costs were minimised and therefore managed in the most effective way although it should be kept in mind that cost alone is not necessarily the only consideration and clearly actual investment returns delivered are of relevance.   1. Governance:  * How well informed do you feel about the governance of your fund? What information do you rely on to measure this? * How well is the current system governed? * How would you improve governance of the current system? * How important is it to maintain a local connection with respect to oversight and strategy?   Lothian Pension Fund has a local Pension Board in place who scrutinise the work of the Pensions Committee that itself operates within the governance arrangements of the administering authority. Pension Committee reports are readily available.  As an employer/Council who is not the administering authority, we have significantly less ability to exert appropriate and proportionate influence. Even if maintaining the 11 fund structure currently in place, we would promote breaking the current dominance of the administering authority ensuring that member councils/smaller employers are given a proportionate voice.  Retention of local connection is essential for effective oversight and local employee representatives are well placed to reflect upon local priorities relative to maintaining and satisfying their fiduciary duties.  It is also important to ensure that local decision makers/employers understand the impact of their decisions on the fund e.g. changes in workforce, early retirements, etc. also ensuring that key decisions are effectively communicated to fund administrators.  How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?  With some difficulty! Although many of the positives associated with local connection are obvious, the benefits of scale are less clear and more variable.  Significant changes to the pension scheme were introduced in 2015 along with new, improved governance arrangements - these need time to properly enable evaluation of the effectiveness of change – there have been some positive signs of enhanced governance with greater and more effective employee/employer representation in funds.  To the best of our understanding, the current audit regime has not identified or reported any concerns with current governance arrangements.   1. Operating risks:  * How well informed do feel about the operating risks of your fund? What information do you rely on to specify and measure these? * How well are operating risks managed in the current system? * How would you improve the measurement and management of operating risks in the current system?   Pension fund have scrutiny committee in place to review funding and investment strategy  Pension Board and Committee get regular updates from fund managers on risk register RAG ratings.  There is also regular reporting to Audit and Governance committee of the Administering Authority attended by pension committee and pension board members.  Availability of risk register to participating employers through Administering Authority Audit and Governance Committee.   1. Infrastructure:  * How well informed do you feel about your fund’s investments in infrastructure? What information do you rely on? * How do you rate the current system’s ability to invest in infrastructure? * How would you increase investment in infrastructure in the current system?   Reasonably well informed as relevant information is reported through Annual Report; bi-annual meetings and other fora.  There are good examples of where this is happening with Lothian PF collaborating with other funds on Infrastructure investment  We strongly believe that potential use of Pension fund to invest in infrastructure should not be a driver for any structural change.   1. Do you have any additional comments about this option?   Potential investment options should only be considered if the related returns justify investment level – this should always be a decision for pension fund investment managers and should not be driven by political policy objectives. |

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| Question 2: Promote cooperation in investing and administration between the 11 funds The text can wrap onto additional pages. |
| 1. Cost of investing:  * What impact do you think promoting agreements between funds would have on investment costs? * What would be the positive impacts? * What would be the negative impacts?   It would be hoped that potential cost benefits might accrue but again worth noting this in itself should not be considered a sole driver. This could be done on a voluntary basis as currently the case with some joint work across funds led by Lothian Pension fund.  It is recognised and accepted that benefits can be obtained in terms of reduction in fees through economies of scale and potentially benefits for smaller funds to access potential gains that might not currently be available to them.     1. Governance:  * What impact do you think promoting agreements between funds would have on governance? * What would be the positive impacts? * What would be the negative impacts?   Sharing and more consistently deploying best practice through closer cooperation between funds should have a positive impact  Local investment capacity retained but potential for removal of local decision making.  There are risks associated with slow decision making as a consequence of needing to satisfy all parties to the pooling arrangements   1. Operating risks:  * What impact do you think promoting agreements between funds would have on operating risks? * What would be the positive impacts? * What would be the negative impacts?   Unclear on what would change.  Greater collaboration would potentially increase resilience and allow flexibility depending on the variable demands upon each fund.  Potential risk of loss of experienced staff if one organisation takes the lead.  Increased set up/legal costs due to contractual arrangement between funds.  Issues of liability if performance less than expected for lead fund.  Potential for an increased administrative burden upon funds.   1. Infrastructure:  * What impact do you think promoting agreements between funds would have on funds’ ability to invest in infrastructure? * What would be the positive impacts? * What would be the negative impacts?   Smaller funds would have access to a wider range of investment opportunities on a more cost effective basis. Examples of this are in place in Lothian PF collaborating with Falkirk etc.  Proper guidance / regulation would be necessary to protect funds.  Impact on local community and economy may be detrimental.   1. Do you have any additional comments about this option?   Heywood’s System is used by all funds in Scotland yet there is no national framework in place.  Each fund has its’ own individual contract based on Heywood charging model meaning that smaller funds pay more per head.  Potential to have a more consistent costing model and offering from system. |

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| Question 3: Pool investments between the 11 funds The text can wrap onto additional pages. |
| 1. Cost of investing:  * What impact do you think pooling investments between funds would have on the cost of investing? * What would be the positive impacts? * What would be the negative impacts? * If asset pooling were possible, under what circumstances should a fund consider joining an asset pool? * Under which circumstances should the SLGPS consider directing funds to pool?   There is potential reduction in cost through ability to negotiate better rate if funds have more money to invest.  Potential cost of pooling in setting up investment funds; large initial set up costs- absence of any longer term data to base any decision upon.  Funds in Scotland are healthy, well-managed so there seems little requirement/motivation to change so dramatically.  Joining an asset pool may benefit the smaller funds through potential economies of scale  SLGPS isn’t one fund – directing funds would be done via legislation but why legislate without any established evidence (E&W experience) of benefits. A strong business case is required for each proposal.  One effect of pooling is that fees have been reduced to a level where there are fewer large players left in the market – potential for short term advantages being outweighed in the longer term?  Pooling should only be undertaken if it provides significant advantages to the fund.  Pooling will require additional governance and administrative structure to be established.   1. Governance:  * What impact do you think pooling investments between funds would have on governance? * What would be the positive impacts? * What would be the negative impacts?   Creation would incur additional cost on start-up, would require re-consideration of local pooling/underwriting of small, affiliated bodies.  In pursuit of good governance, there would be a requirement to build in enhancements that compensated adequately for any perceived dilution of local accountability/influence.   1. Operating risks:  * What impact do you think pooling investments between funds would have on operating risks? * What would be the positive impacts? * What would be the negative impacts?   Creation would incur cost on start-up, would require re-consideration of local pooling/ underwriting of small, affiliated bodies.  No evidence pooling arrangements in England and Wales have delivered either cost benefits or improvements in governance.  Some might argue that larger funds have an ability to absorb extra administration.  Potential economies of scale  Allow diversification for funds  The set up and administering costs of pooling may be significant with a likely requirement for substantial levels of professional advice.  Risk of loss of local accountability/influence.   1. Infrastructure:  * What impact do you think pooling investments between funds would have on funds’ ability to invest in infrastructure? * What would be the positive impacts? * What would be the negative impacts?   Smaller funds would have access to a wider range of investment opportunities on a more cost effective basis.  Local investment may be detrimentally impacted.  If more investment in Scotland’s infrastructure is sought, then a robust business case for each demonstrating the benefit of investment should be developed and presented to the funds for consideration. If the investment provides a sufficiently attractive return then it will become of interest to the fund investors!  Do you have any additional comments about this option? |
| Question 4: Merge the funds into one or more new funds The text can wrap onto additional pages. |
| Cost of investing:   * What impact do you think mergers between funds would have on the cost of investing? * What would be the positive impacts? * What would be the negative impacts? * If merging were possible, under what circumstances should a fund consider a merger? * Under what circumstances should the SLGPS consider directing funds to merge?   Merger would require significant restructuring of LGPS investment mandates at significant cost.  Need separation of individual council/employer portfolios because of different arrangements in Council/employer policies  There would inevitably be implications with the systems infrastructure and administration of the 11 funds being merged into one.  Little/no evidence to support assumption that there would be significant cost savings.  Unclear impact on funding levels for individual employers  Concern at what might be the impacts upon actuarial valuation?  A lot of unknowns which would then present as risks to what are relatively stable funds at present.  There are examples of good practice across funds that potentially could be better developed in a single fund  Governance:   * What impact do you think mergers between funds would have on governance? * What would be the positive impacts? * What would be the negative impacts?   Significant impact on local governance for funds/councils who currently administer schemes but potentially also for others dependent upon how effective any new arrangements might be established.  Possible longer term savings from streamlined back office function once that is in place.  New and effective governance arrangement would be required and although this would present a major challenge and opportunity, it would inevitably incur costs.  Potential TUPE /severance of employee’s time and cost of resources to support.  Any formal restructure would dilute links to local decision making with regard to investments strategy and asset allocation removing a key role from elected members in the governance of pension funds.  Pension Boards would potentially lose/diminish the local connection with fund employers.  Operating risks:   * What impact do you think mergers between funds would have on operating risks? * What would be the positive impacts? * What would be the negative impacts?   Appropriate expertise could be lost.  Full merger likely to require complex and expensive restructuring.  Infrastructure:   * What impact do you think mergers between funds would have on funds’ ability to invest in infrastructure? * What would be the positive impacts? * What would be the negative impacts?   A larger fund may have more appetite for alternative infrastructure investments  Unclear effect of merger on individual funding levels although we would anticipate that individual employers would be protected/ring fenced. |

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| Question 5: Preferred and additional options The text can wrap onto additional pages. |
| 1. Which option does your organisation prefer? Please explain your preference.   Option 2   * Collaboration already exists and the group agree that extending this is valuable. * Promotion of co-operation should be done through a framework as opposed to rigid legislation * Exploration of an incentive scheme to encourage the cooperation (e.g. leave the severance arrangements as is)  1. What other options should be considered for the future structure of the LGPS?   Agree that current options presented reasonably reflect those available   1. What would be the advantages and disadvantages of these other option for funds’ investment costs, governance, operating risks and ability to invest in infrastructure?   N/A   1. Are there any other comments you would like to make?   No |

The consultation questions end.