## 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 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 organisationparticipating in this response. | **Organisation type**Is your organisation an administering authority, employer, or employee group? Please record for each responding organisation. |
| Edinburgh Leisure | Employer |
| **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. |
| Kevin Johnston, Commercial Director, Edinburgh Leisure | consents |
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| **Date**Please date the response. | 07 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. |
| As an employer, we rely hugely on the Lothian Pension Fund (LPF) team as pensions management is not within the core competencies of our internal staff. As such, we tend to engage with LPF on specific items as they arise, rather than us taking an active interest in the detailed administration of the fund. Therefore, we do not feel that we can add anything significant to the responses being submitted by LPF to the detailed questions.The Edinburgh Leisure submission therefore deals only with question 5: our opinion of the tabled options and our request for inclusion of an additional area of consideration on investment costs.  |

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?
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?

How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?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?
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?
1. Do you have any additional comments about this option?
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| Question 2: Promote cooperation in investing and administration between the 11 fundsThe 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?
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?
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?
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?
1. Do you have any additional comments about this option?
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| Question 3: Pool investments between the 11 fundsThe 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?
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?
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?
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?

Do you have any additional comments about this option? |

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| Question 4: Merge the funds into one or more new fundsThe text can wrap onto additional pages. |
| 1. 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?
1. 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?
1. 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?
1. 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?
1. Do you have any additional comments about this option?
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| Question 5: Preferred and additional optionsThe text can wrap onto additional pages. |
| 1. Which option does your organisation prefer? Please explain your preference.

From the enquires we have made and the information we have considered, a full merger would be, prima facie, our preferred option. However, there are two significant caveats which we would put on the implementation of any such option:1. That cost is not the prime driver. During the consultation launch meeting in June, I was concerned that almost every contribution referred to the costs of running the 11 funds, which is only part of the picture. Any merger must be based on an assessment of net bottom line impact on the fund. If changes to create a merged body result in lower administration costs, but also lower fund values (due for instance to higher investment management costs or poorer investment performance), then this would clearly not be a position which we would support. This positive bottom line requirement links inextricably to our response to question **b)** below.
2. That there is no diminution of service to us as an employer. LPF staff have always been very responsive to any questions from us and have met us on a number of occasions to discuss particular items face to face. If we cannot be guaranteed of the same level of service from a merged body, we would not be supportive of any such change.
3. What other options should be considered for the future structure of the LGPS?

Having sought additional contextual background information from the LPF, we are minded to request that the review takes a broader consideration than the options listed. We understand that at least 92% of fund costs are investment management fees. As governance costs are therefore only a fairly small proportion of total fund costs, any change to the administrative structures of the funds is likely to be missing the bigger opportunity.We understand that LPF’s model of managing a significant proportion of the fund via internal investment managers has resulted in strong fund performances in conjunction with significantly lower investment management costs than externally managed LGPS funds across the country (see LPF’s response to the consultation for detailed explanation and financial evaluation). We also understand that there is wide precedence for such an approach, including the University Superannuation Scheme in the UK and a variety of other public bodies across the world. We also understand that whilst delivering savings on cost, such in house investment teams have also delivered greater returns than external fund managers, accepting of course that such outperformance can never be guaranteed. However, if in house teams are well recruited and managed, we believe there is reason to be confident of significant bottom line improvements.The options of greater cooperation between funds or investment pooling of funds would only recognise benefits in relation to investment management costs if the resulting fund was managed by an in-house team. Given that the LPF is the only Scottish fund with an in-house investment management team, we would conclude that options 2 and 3 would be unlikely to deliver on material overall fund management cost savings unless the LPF model of in-house investment management is used.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?

As noted, funds investment costs could reduce significantly if the LPF model was followed, but most funds will simply be too small to have their own in-house investment management teams, hence our support of the merger option. It is important to recognise that even if another group of funds wished to adopt the in-house investment management approach, they may find their council HR processes would limit their ability to attract and retain top fund management talent.We make no representation in respect of infrastructure investments as the fiduciary responsibility of the fund managers requires them to act in the best interests of scheme members and employers rather than to make investments mandated or encouraged by political or environmental pressure. We trust that infrastructure investments are considered along with all other asset classes and in discharging those aforementioned fiduciary duties, infrastructure investments will be made if they are in the best interests of scheme members and employers. 1. Are there any other comments you would like to make?

It is worth noting the practical consideration of any proposal to create a merged body which would include an in-house investment team: Given that LPF is the only fund in Scotland with an in-house investment team, a scaling up of the LPF team to incorporate the greater funds under management is probably the most pragmatic route to achieving the aforementioned benefits in the short/medium term. If this option was deemed not to be politically expedient, another possible response may be to encourage mergers on a voluntary basis, with the caveat that the SLGPS Advisory Board mandates immediate full cost transparency and maintains oversight for the next five years, with a view to collating and comparing all fund performances over that period. The Advisory Board could flag up now their intention to conduct a further review in 5 years with the potential outcome being a mandated merger to a best in class model if the individual funds cannot evidence that they have taken steps themselves to reduce total costs as a proportion of fund values whilst delivering investment growth which compares favourably to a stated benchmark. |

The consultation questions end.