## 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-institute.org](mailto:consultation@pensions-institute.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. |
| Police Scotland/Scottish Police Authority | Multi fund 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. |
| Sharon Dalli, Pensions Manager, Police Scotland  On behalf of;  Hugh Grover, Chief Executive, Scottish Police Authority  James Gray, Chief Financial Officer, Police Scotland | Confirm |
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| **Date** Please date the response. | 12 December 2018 |
| **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 the Scottish LGPS is a multi-employer pension scheme, responsibility lies with the pension fund administering authority’s role as Scheme Manager for areas of investment, governance and operating risks on a day to day basis. As such we have provided a summary response to each of the questions posed in this consultation from our perspective as a multi-fund employer.  **Background**  Police Scotland and the Scottish Police Authority “SPA” were established on 1st April 2013 by the Police and Fire Reform (Scotland) Act 2012.  SPA is the employer for all staff in both Police Scotland and the Scottish Police Authority. SPA is a scheduled body within the Local Government Pension Scheme “LGPS”.  Prior to 1st April 2013, each of the eight police forces in Scotland were deemed a scheduled body employer for LGPS in the fund of their local authority area.  Staff who transferred on 1st April 2013 to SPA remained in the LGPS fund they were a member of at that time. Since then, new recruits have been admitted to the LGPS fund based on their work location.  This means that we currently have staff in eight of the eleven\* LGPS funds in Scotland and new staff joining our organisation are admitted to one of eight different funds, according to where their post is geographically based.  As at 31/3/2018 of our 5,263 employees contributing to LGPS, approximately half are members of the Strathclyde Pension Fund, with 17% in Lothian Pension Fund, and 8% in both North East Scotland and Tayside Funds, with those remaining spread between 3-5% across Dumfries & Galloway, Falkirk, Fife and Highland Pension Funds.  This approach was adopted to ensure that there is a fair admission of new entrants across each of the eight funds that our staff are in. However there are challenges with this approach since the geographical footprint of our national organisation is no longer aligned to previous local authority fund areas.  Although we are recruiting staff there is a risk of being treated as a closed employer in any of the eight LGPS funds we are in due to the geographic workforce profile.  The sustainability of such an approach is therefore diminishing as our organisation develops, resulting impractical inefficiencies in administration and communications, as well as governance and financial implications, for example;   * increasing administration burden on our HR and payroll functions dealing with eight separate LGPS funds with differing requirements * potential confusion around which fund staff are in * differing communications for staff even though they are in the same scheme * different employer contribution rates, funding assumptions and funding levels impacting on our budgeting and governance requirements * restricts our ability to engage in pension board governance as a multi fund employer * additional complexity in compiling statutory annual report and account requirements for staff pensions and executive disclosures.   \*not in Shetland, Orkney or Scottish Borders funds. | |

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?   Cost of investment  We recognise steps have been taken by Lothian Pension Fund to reduce investment costs through their in-house investment team, and the broader efficiencies of their collaborative investment initiatives with Falkirk and Fife funds. At a global level, we note that best practice is for larger funds to manage more of their assets in-house with less reliance on external Investment Managers and the higher costs associated with this.  We also acknowledge the UK pension industry-wide debate on the lack of transparency and reporting on investment costs, particularly those associated with external investment managers which impacts the comparability across LGPS funds. There is a significant opportunity to improve the measurement and management of investment costs through a requirement for LGPS funds to implement consistent and transparent reporting of investment fees and engage with the industry cost benchmarking exercise in this respect.  As an employer, it is important that the LGPS in Scotland can be sustainable for all those participating in it over the longer term and employer contribution rates are set at manageable levels to ensure continued participation and appropriate level of funding for the scheme, recognising the significance that investment performance, risk and costs have in this respect.  **Governance**  Our ability to actively participate in the governance of each of the funds is restricted as a multi fund employer. We currently have employer representation on the Pension Board of one fund, Lothian Pension Fund.  We recognise that the governance structures and the level of involvement from employers, particularly non local authority bodies, can vary amongst funds. This highlights a lack of commonality and ability to seek appropriate assurance on the overall effectiveness of the LGPS in Scotland.  As a national employer in Scotland, we recognise the importance of local relationships and partnerships with the local authorities at a day to day level, however as one Service, our oversight and strategy takes place at national level. In respect of the pension funds our operating model no longer aligns to that of the local authority LGPS funds our staff are in. In many cases, our staff in our Corporate Services function dealing with the funds on a day to day level are based in one of our three service hubs in the North, West and East.  **Operating risks**  We recognise that although one LGPS in Scotland, each fund has differing approaches to investment, governance, administration etc, and resulting operating risk controls/appetite. This again highlights a lack of commonality and ability to seek appropriate assurance on the overall effectiveness of the LGPS in Scotland.  **Infrastructure**  We recognise that the importance of the application of fiduciary duty towards the pension funds’ investments, is to pay the pension benefits for the members, our employees, whilst seeking to ensure adequate funding levels and sustainable employer contribution rates over the longer term.  Whilst investment in infrastructure may fulfil these aims it is a matter for consideration as part of the overall implementation of the agreed investment strategy of the fund.  **Additional Comments**  As mentioned above, the current structure is no longer aligned to our national workforce and we do not believe it is sustainable for us to continue as a multi fund employer over the longer term.  Given the pressure on public service to make budget savings, and the challenges facing the Scottish LGPS (as outlined in the Scottish LGPS Scheme Advisory Board structure review report), it is important that we can offer a pension scheme that is sustainable over the longer term and one where we can meet our financial obligations as the employer.  We believe there are efficiencies to be gained as mentioned above, through improvements to achieve economies of scale in funding and investments, transparency of investment costs, removing duplication and reducing risk in governance and assurance of the LGPS in Scotland, which would lead to better sustainability and control over rising employer costs in the longer term.  In addition, increasing pension scheme legislation and regulations require dedicated expert resource for the pension fund as opposed to reliance on local authority officers who may have conflicting priorities with other council responsibilities they may have and expose a key man risk, particularly in smaller funds. Any opportunity to improve the service to members, to ensure consistency of communications and administration whilst reducing risk should be harnessed along with existing best practice. |

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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?  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?   We recognise that there has been some good progress to collaborative working initiatives as referred to above with Lothian, Falkirk and Fife on investments. This approach provides opportunity where for example, a fund feels infrastructure is a viable vehicle, but either small fund size or relative large charges may not make that feasible in current structure. Also with funds pulling resources and materials for the introduction of public service pension reform in 2015. However we also appreciate there are limitations to the scalability of this approach which could restrict the level of efficiency that could be achieved.  It also brings a requirement for like minded partners to work together with effective governance in place, to exploit the scale of efficiencies available which may not be practical, achievable or sustainable across all funds on a voluntary basis.  As a multi fund employer, collaboration in administration could still result in different approaches amongst funds, unless one common approach was adopted across all which also risks dilution of local expertise and best practice within each fund. |

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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?  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?  Whilst acknowledging investment pools have been formed for LGPS funds in England and Wales, we understand that it is too early yet to rely on their experience to form a view on the potential cost and benefits of doing so. We support any efforts to pool investments to achieve cost savings and benefit from economies of scale however believe that retaining eleven different funds with one common investment pool could give rise to further challenges in governance and implementation of funds’ investment strategies. Generally we understand the LGPS funds in Scotland to be in a better funding position than those in England and Wales so the appetite amongst funds to align in investment pooling may differ. This could release the opportunity for savings and benefits to be realised. For example, some funds may be moving more towards a low risk investment strategy if they have a strong funding position, which does not align to the objective of the investment pool. It would therefore be important for the structure of the investment pool to allow for the required individual funds investment strategies. As it stands not all funds currently have access to the same investment opportunities due their size and relative costs, despite members being in the same scheme which may be resolved by investment pooling. Also we recognise that Strathclyde Pension Fund is already of a similar size to the pooled funds set up in England and Wales so arguably the benefits of scale for the largest LGPS fund in Scotland are already in place.  We understand that there are varying governance models in place in England and Wales between pools and lessons should be drawn from their experience. Where pooling could bring improved investment decision making with professional specialised resource, including internal investment management, it adds an additional layer of governance between the fund and the investment manager and has the potential to complicate the strategic investment decisions with their implementation and reduce transparency and diluting the ability to influence at individual fund level, unless an effective governance structure is in place. |

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| Question 4: Merge the funds into one or more new funds The 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?   As a multi fund employer we believe that a move to one new fund best aligns to our national organisation operating model. This would rely on a revised governance structure to be put into place, i.e. different from the existing authorities and for the funding position of different employers to be protected to prevent cross subsidies. The importance of fiduciary duty should be paramount to ensure the governance of the new merged fund operates in the best interests of its members and employers.  We also believe that reform of the structure of the LGPS in Scotland is required to ensure sustainability in the longer term, as outlined above. Merging funds would provide an opportunity to achieve economies of scale in investment but also in-house investment providing effective governance, resource and expertise is put into place. We believe this approach with less reliance on external investment managers, better risk control and cost savings, would drive more sustainable levels of employer contributions over the longer term relative to performance without any detriment to members benefits. However we recognise the significance of the work required to achieve this aim and the pace at which a change of this scale would need to be successfully delivered. |

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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. 2. What other options should be considered for the future structure of the LGPS? 3. What would be the advantages and disadvantages of these other option for funds’ investment costs, governance, operating risks and ability to invest in infrastructure? 4. Are there any other comments you would like to make?   We would support a recommendation to take forward Option 4 to merge into one fund as the preferred solution on the basis that a full business case, risk assessment and due diligence exercise is carried out to assess the required approach, timescales and costs of implementation accepting that the longer term benefits will outweigh the set up costs. We expect that to enable this to be successful it is paramount that the appropriate governance structure is put in place to ensure the fund can effectively exercise its’ fiduciary duty for the benefit of its’ members and employers and avoid the risk of any potential conflicts of interests, for example with any directive investment initiatives e.g. in local infrastructure.  As mentioned above as a multi fund employer to ensure sustainability over the longer term, we would prefer for all our employees to be within one LGPS fund. However there are challenges in the differences in funding and governance amongst the existing funds with differing funding levels amongst the existing funds and realisation of any cessation shortfall among the financial barriers to consolidation. These challenges although not insurmountable would be removed if the current LGPS funds were merged into one fund.  We believe that any consideration to a staged approach to implementation based on an initial merge to more than one fund, would require a directive rather than voluntary approach for the existing funds to work together to deliver an effective model in order to make such  ‘Merged Funds’ into a viable reality. This approach should ensure an effective governance structure is established, a consistent approach to the transparency of costs and utilisation of in house investment management, to drive sustainability of employer contributions in the longer term. An appropriate governance mechanism should be put into place to oversee this transition. |

The consultation questions end.