## 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. |
| Shetland Islands Council | 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. |
| Jamie Manson, Executive Manager – Finance, Shetland Islands Council | Confirm |
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| **Date** Please date the response. | 12th 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. |
| Shetland Islands Council is the Administering Authority for the Shetland Islands Council Pension Fund.  Key figures for the Shetland Islands Council Pension Fund as at the 31st March 2018 are as follows:  **Membership**   |  |  | | --- | --- | | **Membership** | **2017/18** | |  |  | | Employee members | 3,358 | | Pensioners | 1,851 | | Deferred members | 2,044 | |  |  | | **Total Membership** | **7,253** |   The population of the Shetland Islands at the 31st March 2017 was 23,200. The membership of the Shetland Islands Council Pension Fund is therefore equivalent to around 31% of the population.  **Employers**  There are 12 employers in the Fund with active members, this includes scheduled bodies and admitted bodies.  **Funding**  At the March 2017 triennial valuation the Fund had a calculated 90% funding level.  The Shetland Islands Council as the main employer within the Fund pays a contribution rate of 20.8%. This rate was set at the 2017 triennial valuation and remains the same up to 2020/21.  **Investment Assets**  The Fund had a value of £459 million at the 31st March 2018. The Fund is invested in a diversified global strategy using five fund managers. All of the Fund’s managers have signed up to the United Nations Principles on Responsible Investment as required by the Fund’s Statement of Investment Principles.  The Fund’s investment strategy is invested as follows:   |  |  | | --- | --- | | **Asset Class** | **Allocation %** | |  |  | | Global Equities | 40 | |  |  | | Diversified Growth Fund | 20 | |  |  | | UK Equities | 18 | |  |  | | UK & European Property | 12 | |  |  | | Alternative Bonds | 10 | |  |  |   **Investment Performance**  3 years 7.1% p.a.  5 years 7.4% p.a.  10 years 6.2% p.a.  **Fund Manager Fees**  The current average level of fund manager fees for the Shetland Islands Council Pension Fund is 0.27% of the value of assets under management. |
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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?   The Shetland Islands Council Pension Fund complies fully with the disclosure of investment costs as per CIPFA guidance in its Annual Report and Accounts.  All investment costs are reconciled from the fund manager’s records on a quarterly basis and analysed between the different costs.  All investment costs are agreed at the initial set up of an investment management agreement with a new fund manager, and the new Code of Transparency requires further disclosure of fund manager’s transaction costs.  All of the Shetland Islands Council Pension Fund investment fund managers are signed up to the Code of Transparency.   * How well does the current system manage investment costs?   Investment costs are discussed with investment consultants at the initial outset of an investment strategy review project. When interviewing prospective fund managers during a tender for a new mandate, the fund managers are questioned on their investment costs using the competitive situation to try and reduce costs.  An Investment Management Agreement with a fund manager always includes a section on investment costs so it is clear from the outset. There are other types of daily fund manager trading costs from purchasing and selling assets. Again these are reviewed against the turnover of investments to ensure this is appropriate for the agreed mandate.   * How would you improve the measurement and management of investment costs in the current system?   There have been recent developments in this area with the new Code of Transparency for LGPS asset managers, requiring them to provide cost collection templates. The FCA has also convened a working group to develop the existing cost templates further.  The competitiveness in the fund management industry has brought down costs over the past few years and the Code of Transparency is increasing the disclosure of costs, these measures by themselves are improving the measurement and management of investment costs.   1. Governance:  * How well informed do you feel about the governance of your fund? What information do you rely on to measure this?   In line with LGPS legislation the Fund established a Pension Fund Committee which discharges all functions and responsibilities in relation to the governance of the Fund, along with a Pension Board to assist with the compliance of scheme regulations and the requirements of the Pensions Regulator. The Pension Fund Committee and Pension Board meet at least quarterly to review all aspects of the fund’s investments and administration. Both of these bodies are supported by Shetland Islands Council officers, investment consultants, actuaries, the custodian along with the Council’s internal audit service and other Council committees such as the Audit Committee that can review, check and scrutinise all aspects of the Pension Committee’s work.  The Pension Fund produces an Annual Report and Accounts which is an externally audited document. This includes an Annual Governance Statement which documents the governance arrangements for the Fund. The statement also evaluates these governance arrangements against the Code of Corporate Governance to ensure compliance with best practice and to identify any areas that require improvement. If any governance issues were found these would also be reported in the external auditors report on the Annual Report and Accounts.  <http://www.shetland.gov.uk/finance/Pensions.asp>   * How well is the current system governed?   The governance of the Scottish LGPS was reviewed and enhanced recently with new legislation and regulations, which resulted in the requirement to produce separate externally audited Annual Report and Accounts, and the establishment of a Pension Fund Committee and Pension Board which has both employer and union representation, for each Scottish LGPS.  No significant issues have been highlighted by Audit Scotland which in itself suggests there are no significant governance issues with the individual Scottish Funds.  The governance of the Scottish LGPS is further supported by Council officers with external Independent Auditors who review and scrutinise all aspects of the Fund’s operations. The Pension Fund takes advice from external advisors who have extensive experience of the LGPS throughout the whole of the UK, and therefore helps the Pension identify best practice.   * How would you improve governance of the current system?   The recent regulatory changes have improved the overall governance of the Scottish LGPS to a high standard, but ongoing review is to be welcomed. This could perhaps be best conducted by an independent audit to not only ensure all Scottish LGPS are compliant with the regulations but to assist and help with any areas of improvement.  Pension Boards were set up under recent legislation and these include employer representation but the Board does not have voting or decision making ability. This could be reviewed to allow the Board to have more capabilities.   * How important is it to maintain a local connection with respect to oversight and strategy?   It is imperative for accountability of decision making to maintain a local connection with respect to oversight and strategy. If Full Merger of Funds was decided, resulting in a Single Fund for LGPS Scotland, the local connection between the Fund’s performance and the Employer contributions to the Fund would be lost.  The Council is the main employer into the Pension Scheme and it is Council officers that maintain and operate the Pension Fund to ensure members receive a good service but also an efficient and well run Pension Fund will help to keep employer contributions at an appropriate level. This maintains a high level of accountability and scrutiny with a good service for the members while there is overall community responsibility by the local authority.  The local approach to the Scottish LGPS combines the benefit to scheme members within the community to the cost of the scheme to the local employers. This level of accountability and oversight would be lost with a merger option as employer contributions would be disconnected with local pension members. Any meaningful oversight by the scheme members and the employers would then be very remote.  The investment strategy is integral to the financial position of the pension fund and is specifically designed and implemented for the benefit of employers and employees. This is put together in conjunction with the contribution/funding strategy which is also set locally, as contributions are paid by the Council and other local employers. It would seem appropriate that there is a strong level of local accountability for the risk appetite inherent in the investment and contribution strategies combined, since these fall on the local employers.  The local scrutiny of the strategy by employers and employees through the current governance arrangements allows direct questioning at all stages of the strategy process. The increased disconnection of a merged Scottish fund could not allow this level of employer and employee scrutiny therefore lessening governance of the key interested parties.  The membership of the Shetland Islands Council Pension Fund in total is equivalent to about 31% of the population of the Shetland Islands. This shows how important to the local economy the pension fund is, and how important that there is a local connection to the oversight and strategy of the Pension Fund. The Fund sets its investment and contribution strategies locally, using a risk management framework which is appropriate to its local employers, and subject to local scrutiny: this approach has served the SLGPS well to date.   * *How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?*   It seems logical that local governance of the Shetland Pension Fund which is important to the local community is better served by local interested parties monitoring and deciding on issues. Removing a local connection makes it no less important to that community, and the level of importance and scrutiny cannot be replicated in any other type of organisation that is remote from the community.  Evidence of any other type of Scottish LGPS model is unknown and not tested, it is therefore difficult to quantify any costs or benefits as these could not be estimated with any real accuracy. Only the current Scottish LGPS position can actually be evaluated, and there is no evidence to suggest that the current model requires change, indeed all of the Scottish LGPS funding positions are very healthy irrespective of their scale, which is a direct output from good long term local governance.   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?   The Shetland Islands Council Pension Fund has a risk register that is reviewed regularly.  External auditors undertake an annual assessment of the internal controls as part of their audit process. Furthermore, our external advisors work with us, providing specialist expertise drawing on extensive experience elsewhere in the UK LGPS, to help us maintain best practice in this area.   * How well are operating risks managed in the current system?   Both internal and external audit have not identified any significant issues in the Pension audits they have undertaken.  Operating risks are managed in all areas of the Fund, from internal and external audit reviews to having business continuity plans. Investment risks are paramount within the setting up of an investment strategy from the use of investment consultants, through to the diversification of fund managers and the independence of the custodian. Internally within the Council there are segregation of duties with all cash movements, and the reduction of key man risk through the involvement of various Council officers at all levels.  The Pension Fund has the backing of Council staff and its operating controls which are also externally audited to ensure all operating risks are managed throughout all of the Pension Fund’s operations.  All internal and external use of risk control is used to mitigate all possible risk and safeguard assets, which is reflected in the external auditors clean audit report.   * How would you improve the measurement and management of operating risks in the current system?   Due to the complexity of the LGPS and other associated regulations, it’s imperative to undertake continual staff development/training to ensure all pension administering staff are fully trained and multi-skilled so as to ensure key man risk is mitigated. Operating risks have been significantly improved now that all 11 Scottish Pension Administering Authorities are using the Heywoods Altair Pension Administration System. We are also making greater use of our external advisors to reflect the greater focus on these issues.   1. Infrastructure:  * How well informed do you feel about your fund’s investments in infrastructure? What information do you rely on?   The Shetland Islands Council Pension Fund does not currently have any investments in infrastructure.  All investments are compared and analysed by our investment consultant before deciding which assets best fits into the Fund’s investment strategy. The current investment strategy was agreed in 2014 and a review of this strategy has just been initiated with our investment consultants, with the intension to have a new investment strategy in place during 2019. This strategy may include infrastructure investments as it will be compared again to other asset classes during the consultant’s analysis.   * How do you rate the current system’s ability to invest in infrastructure?   Infrastructure will be evaluated against all other asset classes by investment consultants, when they look at compiling the new investment strategy.  Infrastructure investing does have different governance characteristics, is more expensive to invest into, relatively illiquid and there are supply constraints. This does mean that investing directly into infrastructure requires specialist knowledge but there are different options to direct investing that could be utilised if the asset class was perceived to be a good investment for the fund’s strategy, through to pooled vehicles already available and established in the pension investment universe.   * How would you increase investment in infrastructure in the current system?   Any investment into infrastructure would have to be recommended initially by the investment consultants and believed to be a good addition and diversifier within the investment strategy, relative to alternative investment options.  Infrastructure is not treated differently from of any other asset class when comparing investment options: the aim of the Fund is to balance risk and return for the benefit of participating employers, ensuring the payment of benefits to all our members.  If there were a greater number of attractive infrastructure vehicles available it would increase the potential appeal of investment in this area. This is possibly where greater collaboration between the LGPS could assist with looking at prospective infrastructure products and assisting with the due diligence requirements.   1. Do you have any additional comments about this option?   To restructure the Scottish LGPS simply to secure additional investment in Scottish infrastructure could be a hugely costly mistake. If the Government’s aim is to increase infrastructure investment, then it would be best achieved from the supply side (i.e. making suitable projects available for Funds to invest in) rather than mandating a demand for a limited number of opportunities.  The 11 Scottish LGPS Funds are all in a healthy position with good funding levels approaching or above 100%. This shows that the current system, with 11 Local Authority Pension Funds, is achieving security and protection over their member’s future pension payments. This is the aim of a pension scheme and the Scottish Funds are achieving that aim. The saying of “if it isn’t broken then don’t fix it” appears relevant as the current Scottish LGPS Funds are in a good funding position. In particular, the consideration of pooling and greater focus on infrastructure in England and Wales has been borne partly out of a much poorer funding position south of the border than we experience in Scotland: importing solutions from other parts of the UK which are in very different situations is not necessarily appropriate for the Scottish Funds.  A restructure of the Scottish LGPS would be appropriate if the 11 Scottish Funds were in a very different situation with much lower funding levels, but given the current situation it is difficult to see what the overall benefit a change would make. There are many challenges for the Pension industry but these are being dealt with through proper governance and careful investment management, delivered by local decision-makers, as the results show.  If it is believed that infrastructure is a good long term risk/return asset class for the Scottish LGPS then it requires to be made more accessible and attractive for investment. This could be achieved through increased collaboration, such as the type of infrastructure product that Lothian has put together. |

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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?   Certainly any agreement between funds in relation to a joint procurement exercise would save costs and duplication of work. Any agreed investment, could also save time on due diligence work and save fund manager fees, given the cost structure that fund managers adopt which is based on overall investment size.  Some investment classes could become more accessible to the smaller Scottish LGPS Funds such as infrastructure, where due diligence work and ongoing governance could be covered by the joint agreement.  Costs are important but it is investment return net of costs which is the real measure.   * What would be the positive impacts?   Saving of costs and officer time in procurement and ongoing investment fees. An increased universe of possible investable asset classes.   * What would be the negative impacts?   Setting up and drafting the initial agreements between various Funds, could be time consuming and expensive and may be difficult to achieve agreement.  There could also be significant costs, delays and administration involved with getting revised investment processes put in place.   1. Governance:  * What impact do you think promoting agreements between funds would have on governance?   Initially introducing a new layer of cooperation and setting up agreements with other Scottish LGPS Funds would involve added governance at officer and committee level due to the new nature of the agreements and its complexity.  Once the agreements are in place and operating it would depend on the agreement itself but collective governance could actually reduce individual fund governance.   * What would be the positive impacts?   A collective approach to governance could improve the general governance of the investment, and help spread knowledge.   * What would be the negative impacts?   Initial discussions on the various aspects of any agreement would be a time consuming process. This process could be onerous and issues difficult to resolve due to the complexity of any agreement and the number of parties involved. All agreements need to be maintained, updated, reviewed etc.to everyone’s satisfaction.   1. Operating risks:  * What impact do you think promoting agreements between funds would have on operating risks?   A new contract or agreement between funds will involve, at the outset, new operational controls and risks. This will require additional work initially but after that there should not be any difference to the ongoing operational risk, if anything there should be an improvement to operational risk, in particular key man risk.  The Scottish LGPS already has a good networking arrangement in place for the sharing of information, which includes the IGG and SPLG groups. These groups meet on a quarterly basis along with attending other group meetings such as the Heywoods Pension System bi-annual meetings (i.e. CLASS User Group).  More collaboration with the Funds can only be a positive thing by learning more from each other and would go some way to eliminating duplication of effort, in particular with regard to administration matters.   * What would be the positive impacts?   It depends on what the collective agreement is and how it is set out, but a collective management of risk must benefit operational risk.   * What would be the negative impacts?   A collective agreement will bring at its outset additional issues and work to satisfy risk management. Once the agreement is in operation it will require to be maintained and reviewed which will also require additional resources.   1. Infrastructure:  * What impact do you think promoting agreements between funds would have on funds’ ability to invest in infrastructure?   An agreement between Scottish Funds on an infrastructure product would certainly be beneficial for most funds, as it would remove certain barriers that have prevented them from investing, such as lack of expertise in this area, the increased due diligence, governance required and the level of investment. An agreement would certainly give Scottish Funds the ability and opportunity to invest if it was as seen as an appropriate investment within their investment strategy.   * What would be the positive impacts?   It would give the opportunity for many of the Scottish Funds to invest in another asset class. There may also be benefits with scale to reduce management costs.   * What would be the negative impacts?   There is an increased collective risk and reduced diversification if many of the Scottish Funds invested in the same agreement with the same fund manager; if the returns were poor all of the funds would suffer. This is a greater risk the fewer opportunities there are.   1. Do you have any additional comments about this option?   Significant co-operation between the Scottish LGPS Funds and the wider LGPS network already exists. The introduction of the LGPS 2015, and the associated member and employer communications, was a successful large-scale collaborative exercise between all the Scottish LGPS Funds.  A collaborative agreement between Scottish Funds on infrastructure would open up this type of investment to many of the Scottish Funds that could not invest in this asset class individually.  Scottish LGPS Funds have worked together before on projects, so an agreement on an infrastructure product is certainly a realistic option, which would allow some of the Funds to get access to an infrastructure investment. |

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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?   It is difficult to quantify costs as there is no evidence to suggest that large Funds have lower costs than smaller Funds. With the combination of past efforts by Scottish Funds, and the cost transparency developments, it would seem that the SLGPS is already in a good place  The initial setting up of the pool would be a costly and time consuming project, and it could take many years to recoup the set up and reorganising costs. This is evident from the experience in England and Wales. There would be an economy of scale benefit on costs when investing but any savings would be dependent on the type of investment, as all investments have different cost levels. There are also the significant ongoing costs of the staff managing the pool to be considered.  Reducing investment costs does not guarantee increased returns, so the effect on net-of-fees returns could quite possibly be minimal and out of proportion to the work and upheaval required to establish the Pools.  Pooling therefore looks to be costly to set up and manage which could take many years to recover. Some English & Welsh Funds will not reach break-even point for at least 10 years, and others will actively be worse off as a result of pooling, due to their positive starting point.  The costs involved with pooling will hit employers contribution levels which will have knock on effects to the Council’s own budgets and level of service. This is a concern given the actual situation which is happening in England and Wales.  It appears there is no argument for pooling of Funds when the funding levels of the Scottish LGPS Funds are already good and fee levels are generally quite competitive.   * What would be the positive impacts?   A wider mix of asset classes could be available for investment due to the pool size. Investment strategy would remain under local control, which is crucial as identified above.   * What would be the negative impacts?   Costs from the initial set up of the pool could be very expensive. The time required to decide how the pool will actually be formed and function could run into many years, as England and Wales have found.  This will take up Council officer time adding strain to the Pension service, along with additional Pool costs that will filter through to employer’s contributions which will affect the Council’s services.  Large transaction costs to disinvest and reinvest, reduced selection of fund managers to achieve economies of scale, and possible unavailability of suitably qualified staff for the Pools, would increase investment risk. There is no evidence that a large Fund will save costs, and no guarantee of better investment returns.   * If asset pooling were possible, under what circumstances should a fund consider joining an asset pool?   If a Fund had a high level of fund manager fees, staffing issues and a poor funding level the merits of joining a pool structure might be considered.   * Under which circumstances should the SLGPS consider directing funds to pool?   It would require a situation where a fund was basically failing and not achieving its aims, and required outside help. An assessment of the fund’s situation would need to be conducted to see if it would be beneficial for the fund to join a pool. However Government should take great care before forcing a Fund down a particular course of action which may increase a Fund’s costs in excess of the potential benefits achieved.   1. Governance:  * What impact do you think pooling investments between funds would have on governance?   Pools would create another layer of governance and therefore further remove Pension Fund Committees and Pension Boards from the investments and fund managers. This adds to the complexity of the structure and reduces the Pension Committee’s control and governance over the fund and its investment performance.  Pooling investments would remove employers further from the Pension Fund’s investments and the management and oversight of those investments. This is in complete contrast to the recent legislation that gave employers more responsibility by including them on the Pension Boards.   * What would be the positive impacts?   It is not clear what benefits there would be on governance from pooling investments. It is sometimes argued that the removal of investment manager decisions from local decision-makers would improve matters by focusing their attentions on the more important issue of investment strategy: however this brings into question why significant work is needed to address the lower risk issue of manager selection.   * What would be the negative impacts?   The work and time required to setup the initial pool would require additional resources of governance. Any structure that adds additional management layers such as a pool will increase the governance complexity and time allocated to the governance function.  The recent legislation which improved governance through the set-up of the Pension Board that included employer and Union representation, would see their role significantly reduced regarding the governance of the actual investments and the fund managers.  Reduced ability to deal with poor-performing managers could be an issue: if the Pool is the designated manager but under-performs, how would a Fund remedy this situation?   1. Operating risks:  * What impact do you think pooling investments between funds would have on operating risks?   It is unlikely that there would be any impact on the operating risk with the investments as these would be invested with fund managers as per the current situation. If anything there could be a negative impact due to the potentially limited availability of asset classes: the Funds would be restricted to choose from what the Pool had on offer.  It is unclear how the pools would tender for or select fund managers, and what level of choice of fund managers per asset class the Pension Committee would have.   * What would be the positive impacts?   It would depend on how the pool operated but due to the size and variety of the investments it may give an additional level of due diligence and risk control over the investments.   * What would be the negative impacts?   Pooling will decrease the choice of investment managers and asset classes, so increasing the concentration of the investments with the chosen fund managers. This will have a negative impact on investment risk and operational risk.  The changing governance responsibilities of the Pension Board and the Pension Fund Committee would create uncertainty of roles with the pool which could have possible operational issues increasing risk.   1. Infrastructure:  * What impact do you think pooling investments between funds would have on funds’ ability to invest in infrastructure?   Pooling investments would give an additional size to the overall pool allowing it to consider offering an investment vehicle in infrastructure to the funds. Any fund considering an investment in infrastructure would still have to compare it to other investments and decide if it fits into their particular investment strategy.  Some of the Scottish LGPS Funds are already invested in infrastructure, so pooling may not achieve any sizeable change to the overall investment in infrastructure.   * What would be the positive impacts?   Pooling could offer an infrastructure vehicle which some Scottish LGPS Funds have not had the size or expertise to be able to invest into.   * What would be the negative impacts?   Setting up a pool for investments is a very expensive proposition to try and achieve an increase in infrastructure investment. This could be achieved more easily through the collaboration approach or simply investing in an existing investment pool or insurance contract.   1. Do you have any additional comments about this option?   The current Scottish LGPS structure is a success with all funds close to and exceeding a 100% funding level. To change this structure and introduce a pooled investment structure will create large initial set up costs, costs to reorganise investments plus the continued operational costs of the pool. Agreement on how this structure would operate is unknown, as are the costs.  England and Wales have reorganised the LGPS into eight large pools, which has been under construction for a few years, and still has no known outcome on costs, investment returns or even actual agreements on some of the pool’s structures. This does not set a good example to follow, especially when the Scottish LGPS position is well funded.  Fund manager fees in Scotland have reduced over the past couple of years making further savings through a pool more difficult.  Changing a structure will only add benefit if net returns after costs are improved, which is very unclear from the position in England and Wales.  There are 11 Scottish LGPS Funds all investing specifically for their Pension Funds using many different fund managers in different assets, which creates a very low risk diversified structure. A pool would reduce the diversification of fund managers and asset classes, significantly increasing investment risk through concentration of investment. Pooling investments would create another tier of bureaucracy and would muddy governance responsibilities which in turn would increase operational risk.  As the main employer in the Fund, pooling looks as if it will increase costs, as has been witnessed in England and Wales. This will only increase employer’s contributions unless investment returns are higher and there is no evidence for this. This could continue to be the case for many years with a long term cumulative effect on the Council’s budget and ability to maintain services. Given the current good position of the fund with stable employer contributions the option of moving to a pooled structure does not make sense. |

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| Question 4: Merge the funds into one or more new funds The text can wrap onto additional pages. |
| a) Cost of investing:   * What impact do you think mergers between funds would have on the cost of investing?   It is difficult to quantify cost savings as there is no evidence to suggest that large funds have lower costs than smaller Funds.  There may be cost savings with investing larger amounts but it depends on which asset classes, for example passive equities have seen fees slashed in recent years so any cost savings would be minimal. Some asset classes have an oversupply of investment so would be unwilling to cut fees.  Cost is only part of the investment picture as it is the investment performance return less costs that is important.  Reducing investment costs does not guarantee increased returns.   * What would be the positive impacts?   There is no evidence to suggest that larger funds have lower costs than smaller funds.   * What would be the negative impacts?   A reduction in costs does not guarantee an increase in investment return.  A merger would involve large set up costs plus disinvestment and reinvestment costs of funds being reorganising to go into a merged fund. These costs are unknown but are costs that are not incurred at present so they will be a drag on all of the funds positions for a long time, due to the great upheaval of arranging such a merger.  Scottish LGPS Fund costs are not excessive and the funding positions are good. Any merger would immediately add set up and reorganisation costs, with no evidence that the merged fund will improve costs or investment return.  The costs of restructuring would be significant and could be a drag on fund performance for many years, this would immediately affect funding levels and could lead to increased employer contributions.   * If merging were possible, under what circumstances should a fund consider a merger?   Any options available to a fund should be considered but a fund would only consider alternative options such as merging with other funds if its analysis of that option proved to be a better outcome for that fund and its members. It is difficult to envisage such a situation given the known costs and delays in the short term, and the unknown (and possibly unavailable) cost savings in the longer term.   * Under what circumstances should the SLGPS consider directing funds to merge?   This step could only be considered if a fund was failing and required help. An assessment of the fund’s situation would need to be conducted to see if it would be beneficial for the fund to merge.  b) Governance:   * What impact do you think mergers between funds would have on governance?   There would be a loss of governance over the fund, as local control and accountability would be diminished or completely removed depending on the merger model.  The role of the Pension Board with employer and Union representation which was set up a few years ago to improve governance would disappear. This local governance model which allowed the employers and employees to be involved and assist with the operation of the scheme would be lost with no known future model of governance. This would take governance away from representatives of the people the fund is actually meant to be for.  What would be the positive impacts?  Saving on time and any costs relating to the governance of the fund at local level due to the decrease or ceasing of this function. This would only be a positive if the fund was ultimately in a better funding position with lower contribution rates and/or greater investment returns.   * What would be the negative impacts?   Governance of the merged funds would be further removed losing accountability from the fund employers and members. . The Funds assess contribution and investment strategies using a risk management framework which is appropriate to their local employers, and is therefore subject to local scrutiny and accountability: this would be lost under a merged arrangement.  The current governance arrangements were enhance only a few years ago through the introduction of separate accounts, Pension Fund Committees and Pension Boards. This close level of governance would be lost in a merged situation.  **c) Operating risks:**   * What impact do you think mergers between funds would have on operating risks?   With a merged fund you would have a greater concentration of investment which would create increased operating risk. Poor performance by a fund manager would have a larger impact on the overall fund.  The merged structure and its governance arrangements would be paramount in managing operating risk, to ensure as a minimum that the current standards were maintained.  The larger merged structure would have more staff and resources to rely on, with more advanced risk analysis, to help control the greater mix and size of investments in monitoring operational risk.   * What would be the positive impacts?   More staff and resources available to check, monitor and review the investments, with more advanced risk analysis models, to help control the operational risk of the larger more complicated fund.   * What would be the negative impacts?   Greater range of asset mix will increase operational risk. Larger investments will have a greater concentration of risk, as well as breaking the local accountability link which currently serves the SLGPS well.  The changes required to implement the new structure will be onerous, and from the outset there will be increased operational risk during the changes and with the initial operation of a new larger structure.  d) Infrastructure:   * What impact do you think mergers between funds would have on funds’ ability to invest in infrastructure?   A merged fund may not offer an infrastructure investment. This would have no impact on the Scottish funds that do not at present have this investment but would remove the ability of any Scottish funds currently invested in infrastructure.  The increased size of a merged fund would increase the probability of having an infrastructure investment vehicle as part of its investment strategy, which would open up this investment to the smaller Scottish LGPS.  Some of the larger Scottish LGPS are already invested in infrastructure so merging may not achieve any sizeable change to the overall investment in infrastructure.  Whether it is a few funds merging together or all of the Scottish LGPS merging, the merits of investing in infrastructure would be reviewed against other investments, to see if it would be included in the investment strategy.   * What would be the positive impacts?   The merger of some funds or all of the Scottish LGPS could offer a direct infrastructure vehicle which was not available to some of the Scottish LGPS.   * What would be the negative impacts?   Some of the Scottish LGPS already invest in infrastructure so a merger would make little difference to their infrastructure investments.  The merging of different infrastructure investments would be very difficult and could ultimately increase concentration risk. Restricted options made available by the merged Fund may give rise to a negative impact for those Funds which would require a change in their infrastructure investment.  e) Do you have any additional comments about this option?  A merger of any of the Scottish LGPS Funds would not actually improve funding levels, as the merged position would simply be the sum of the current constituent positions: this is a major issue with this option.  The high funding levels of the Scottish LGPS Funds give reassurance to employers and members that the funds are currently being well governed and able to pay current and future pensions without requiring excessive contributions overall. This is paramount, and any change to this structure would need very good sound evidence to prove that the current good position could be improved for all interested bodies.  The current structure has been in place for many years and has proved that it works and can achieve its objectives. Any change from a successful structure is dangerous without being sure of the outcomes.  The pooling option has proved to be a very difficult and costly option from the experience witnessed in England and Wales. A merger of some or all of the Scottish Funds takes pooling to another level where all functions of the Pension Scheme are merged. This will therefore involve greater costs and changes than was seen with pooling, involving many more unknown outcomes. This will have a negative effect for employers through increased contribution levels which will have a knock on effect to the Council’s budgets and other services.  Any form of merger that included the Shetland Island Council Pension Fund would need to be Island Proofed. This brings in an islands awareness into the decision to ensure that any impact of the change does not harm the interests of the Shetland Community. |

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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.   Out of the four options in the consultation the Shetland Islands Council would prefer Option 1 to “Retain the current structure with 11 funds”.  The Shetland Islands Council Pension Fund at the last actuarial valuation in March 2017 had a calculated funding level of 90% on a prudent basis, which maintains a good ability to cover current and future pensions. This level of funding along with strong governance shows that the fund is well placed for the future.  When you add up all the fund’s current members, deferred members and pensioners the total comes to about 31% of the population of the Shetland Islands. The fund is therefore very important to not only the members, but for the future income and benefit of the Shetland community. Local employers pay the required contributions and bear the investment risk, all under a framework of local scrutiny. Any option to remove local control of the pension fund would require very strong evidence to show that it would be beneficial to the fund and its membership and employers. The options proposed to pool and merge funds have many issues which have unknown outcomes, and they do not have the level of evidence or assurance to make them viable alternatives.  The Council as the largest employer in the Shetland Pension Fund and has played a major role in the Pension Fund from operating and managing the Fund to contributing through employer’s contributions. This along with external legislation, external audit scrutiny and reporting to the Pension Board has resulted in a Fund with a good funding position. This is replicated throughout Scotland and is not a structure in need of major reform.  The Fund has benefitted from the already significant cooperation between the Scottish Pension Funds and it would be good to see this continue with further collaboration on issues relating to both investment and administration, which would help enhance the fund’s position.   1. What other options should be considered for the future structure of the LGPS?   The 11 Scottish Pension Funds have good funding positions and have proved to be a long term success but there are many challenges within the pension domain. This is not an unusual situation and does not require any sudden changes to the scheme but the cooperation between Funds could be enhanced with more collaboration on some of the more challenging issues. A recent example of this would be the joint collaboration on infrastructure investment between Lothian and Falkirk.   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?   A collaborative approach on specific pension issues between the Scottish Funds would allow their combined knowledge and understanding of the issues to be discussed and solutions worked out to the benefit of the Funds and their members. This type of joined approach would always discuss the long term costs, governance and the operational risks.  The ability to invest in infrastructure is again a choice of each fund, based on the merits of that investment against other investments. The collaboration of certain Scottish Funds has already witnessed an instance where the ability to invest in infrastructure was realised.   1. Are there any other comments you would like to make?   The consequences of a large change could have long term detrimental effects to the Scottish pension position, the members and many employers. With a lack of evidence for any change and many unknown outcomes the options to pool and merge appear to present little positive benefit but significant potential costs, upheaval and risk.  Major changes to the operation of the Scottish LGPS should only be considered if there were large problems with the current situation. This is clearly not the case as the Scottish LGPS have good controls in place and have strong funding levels, which this consultation will demonstrate. |

The consultation questions end.