

Review of the Structure of the Scottish Local Government Pension Scheme

CONSULTATION RESPONSE FORM

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 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

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.

Aberdeen City Council	Administering Authority
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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.

Laura Colliss, Pensions Manager, North East Scotland Pension Fund	Confirm
Jonathan Belford, Chief Officer-Finance, Aberdeen City Council	Confirm

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Date

Please date the response.

30/11/2018

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.

<p>The North East Scotland Pension Fund and the Aberdeen City Council Transport Fund are administered on behalf of Aberdeen City Council. Scheme employers within the Main Fund are made up of the 3 Councils – Aberdeen City, Aberdeenshire and The Moray Council along with around 50 other admitted/scheduled bodies with links to Local Government.</p>

<p>As at 31 March 2018 the main fund was valued at £4.1 billion and the Transport Fund at £100m. The 2017 tri-ennial valuation assessed the Main Fund as being 107% funded and the Transport Fund as 94% funded, both increases from the 2014 valuation (13% and 1% respectively). The main employer group (Councils) pay a contribution rate of 19.3% (of pensionable payroll). This rate will remain stable until at least 2021.</p>
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<p>The administering authority's long term goal is for the Fund to achieve a 100% solvency level over a reasonable period of time and then maintain sufficient assets in order to pay all benefits as they fall due. Following the outcome of the 2017 tri-ennial valuation, the Pensions Committee agreed a revised Investment Strategy to de-risk and lock in recent gains. Included within the revised strategy is a 10% allocation to infrastructure – a £100m investment was made in early 2018 and the Fund is currently seeking further infrastructure opportunities.</p>
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<p>As a long term investor, NESPF takes its duty to engage on environmental, social and governance (ESG) issues very seriously, and works with others to effect change. In support of this the Fund is a member of the Local Authority Pension Fund Forum, with one of our Pensions Committee members sitting on the LAPFF Executive Committee. We are also signatories to the UN Principles of Responsible Investment and the Carbon Disclosure Project.</p>

<p>2015 saw the successful restructuring of the NESPF pensions section into 6 distinct teams: investment, accounting, governance, employer relationship, technical and benefit administration. This progressive change introduced 2 new teams; employer relationship and governance, to allow the Fund to address areas of increasing significance and allow it to continue to provide a high quality service to members and stakeholders, within the ever increasing complexity of the LGPS regulatory regime. One of the outstanding success stories, delivered by the new employer relationship team, has been the move to receipt of monthly employer data files. This has led to</p>

significant improvements across the Fund but can be seen in particular in our strong quarterly Pension Administration Strategy (PAS) performance figures.

NESPF has been nominated for multiple national awards, most recently winning 'Public Sector Scheme of the Year' at the Professional Pension Scheme Awards. The Fund was judged against several criteria including investment management, communication, governance, innovation and administration and the win recognises the achievements made in improving our service to members and employers.

The consultation questions follow.

CONSULTATION QUESTIONS

Question 1: Retain the current structure with 11 funds

The text can wrap onto additional pages.

a) 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?*

NESPF believes that our investments are well managed, we continue to review and negotiate fee savings as part of our ongoing investment strategy, with Asset and Investment Manager Performance reported to our Pensions Committee and Pension Board quarterly for scrutiny.

A continuing move towards greater transparency and consistency in investment fees e.g. through the adoption of the LGPS Transparency Code and between the LGPS Funds, could see significant improvement in the measurement and management of investment costs.

Governance:

- *How well informed do you feel about the governance of your fund? What information do you rely on to measure this?*

Governance information on the NESPF can be found on our website at <http://www.nespf.org.uk/TheFund/Governance/fundgovernance.aspx>

The current governance structure complies with the requirements introduced in the Public Service Pensions Act 2013. The Pensions Committee and Board sit jointly on a quarterly basis which allows for greater scrutiny of decisions. Strong attendance at both meetings and training events, in addition to strong engagement demonstrates our commitment to good governance.

Committee report packs, detailed minutes as well as the Pension Board Annual Report are all published on our website to ensure full transparency around governance and scrutiny of decision taking.

- *How well is the current system governed?*

The SLGPS continues to be under intense scrutiny to ensure it remains sustainable in the long term, while at the same time ensuring it is efficiently run, cost effective and clearly accountable to its members and stakeholders.

In our opinion, the current system is working extremely well. However we acknowledge that the governance review carried out by KPMG (on behalf of the

Scottish Public Pensions Agency) identified small areas for potential further improvement to be addressed.

- *How would you improve governance of the current system?*

As above.

- *How important is it to maintain a local connection with respect to oversight and strategy?*

We believe it is vital to ensure a local connection with respect to oversight and strategy. This local accountability would be lost with centralisation to the significant detriment of both members and stakeholders.

How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?

Benefit of scale can not be guaranteed/value unknown therefore can not outweigh the known benefits of a local connection.

c) Operating risks:

- *How well informed do you feel about the operating risks of your fund? What information do you rely on to specify and measure these?*

NESPF operates a Risk Register – this is reviewed by the Pensions Committee on a quarterly basis. The Fund operates robust risk management controls, risk awareness is embedded into the investment management process and features in the training for those with responsibility for administering the Funds.

- *How well are operating risks managed in the current system?*

As above

- *How would you improve the measurement and management of operating risks in the current system?*

Continue to ensure those charged with governance of the Fund have sufficient knowledge to be able to effectively consider and challenge operating risks.

d) Infrastructure:

- *How well informed do you feel about your fund's investments in infrastructure? What information do you rely on?*

NESPF has, to date, invested £100m in global infrastructure and will continue to seek further opportunities. Details are published in the Committee papers on the Fund website <http://www.nespf.org.uk/TheFund/Governance/Committee.aspx>

- *How do you rate the current system's ability to invest in infrastructure?*

As above

- *How would you increase investment in infrastructure in the current system?*

Support structure needs to be put in place to facilitate greater infrastructure investment/opportunities. Danger of focusing on one particular investment type at cost of fiduciary duty of Funds.

e) Do you have any additional comments about this option?

Funding levels across the Scottish Fund's were all extremely positive as at the latest tri-ennial valuation (31 March 2017) with many of the Funds reporting funding levels very close to or indeed over 100%.

The Pension Funds across Scotland are frequent industry award winners, recognising their strength and commitment to successful delivery of the SLPGS.

Nevertheless, we acknowledge there is scope for improvement, with the main key areas being highlighted within the SAB consultation report e.g. duplication in external costs, requirement for greater transparency and reporting etc and these have the potential to result in quicker wins. Based on the information provided, there remains a strong and clear argument, which we will aim to set out, in favour of incremental rather than radical change to the SLPGS.

Question 2: Promote cooperation in investing and administration between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think promoting agreements between funds would have on investment costs?*

There would likely be some cost saving from joint arrangements.

- *What would be the positive impacts?*

As above, however we recognise it would be more beneficial/advantageous for the smaller Funds who could benefit from resources of the larger Funds.

- *What would be the negative impacts?*

No negatives

b) Governance:

- *What impact do you think promoting agreements between funds would have on governance?*

No significant impact

- *What would be the positive impacts?*

Reduction in governance, immediate cost savings from joint projects/procurement

- *What would be the negative impacts?*

No negatives

c) Operating risks:

- *What impact do you think promoting agreements between funds would have on operating risks?*

No significant impact

- *What would be the positive impacts?*

Benefits to risk management

- *What would be the negative impacts?*

No negatives

d) Infrastructure:

- *What impact do you think promoting agreements between funds would have on funds' ability to invest in infrastructure?*

Potential for cost reductions and could provide support for some of the smaller Funds to increase their infrastructure investment.

- *What would be the positive impacts?*

As above

- *What would be the negative impacts?*

No real negatives although may be challenges with governance

e) Do you have any additional comments about this option?

Further support should be provided to Funds to help increase/promote collaboration and improve efficiency.

NESPF are already taking part in joint procurement exercises through our administering authority (e.g. for external legal services) as well as using the national LGPS frameworks – collaborative procurement/frameworks should continue to be progressed as a proven means of ensuring cost efficiency savings.

The Lothian model and current collaborative projects between Scottish Funds demonstrate that increased collaboration can be achieved voluntarily and the real benefits that can be achieved under the current status quo structure.

NESPF have long been participating members of the CLASS (Computerised Local Authority Superannuation System) group which was formed to allow public sector pension schemes to work together with a single software provider to ensure LGPS requirements are delivered with development cost shared amongst the group. CLASS is a successful public/private partnership that benefits from regular collaboration amongst the 11 Scottish Funds. Along with Strathclyde Pension Fund, NESPF has assumed an active role on the Testing Working Party, one of several collaborative working parties within CLASS, which focuses on testing system development delivered in software releases. Officers remain committed to engaging and supporting further participation in these, and similar, beneficial CLASS activities.

In the last year NESPF have also welcomed a number of calls and visits from other LGPS Funds, the Civil Service and HSC BSO Northern Ireland, with whom we've willingly shared our knowledge and experience in respect of the Funds structure, how we work and what we've achieved over the last 5 years by working together with our employers.

Question 3: Pool investments between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think pooling investments between funds would have on the cost of investing?*

NESPF have already benefitted from reduced investment management fee's (through economies of scale) as a direct result of the pooling across the English & Welsh LGPS Funds. It is unlikely in our opinion that any further significant cost savings could be achieved in the long term to justify the complexity and immediate costs of pooling the Scottish Funds.

In addition, there is no clear evidence of where the tipping point is to achieve economies of scale, therefore pooling does not guarantee any 'real' benefits.

- *What would be the positive impacts?*

As per the SAB report every 0.01% reduction in fees = c£3.5m, however as stated above we do not feel NESPF would benefit from any significant cost savings from pooling.

- *What would be the negative impacts?*

Timely, resource intensive and costly to set up, with no guarantee of cost savings.

- *If asset pooling were possible, under what circumstances should a fund consider joining an asset pool?*

Any pooling should be undertaken on a voluntary basis by Funds

- *Under which circumstances should the SLGPS consider directing funds to pool?*

As above

b) Governance:

- *What impact do you think pooling investments between funds would have on governance?*

Increased complexity and challenges

- *What would be the positive impacts?*

No positives

- *What would be the negative impacts?*

As above

c) Operating risks:

- *What impact do you think pooling investments between funds would have on operating risks?*

Significantly greater operating risks

- *What would be the positive impacts?*

No positives

- *What would be the negative impacts?*

Bespoke employer strategies would be far harder to deliver in a pooled environment.

Far greater risk associated with larger scale investments (types/locations) in pursuit of growth.

d) Infrastructure:

- *What impact do you think pooling investments between funds would have on funds' ability to invest in infrastructure?*

Potential for greater diversification opportunities through economy of scale.

- *What would be the positive impacts?*

As above

- *What would be the negative impacts?*

May prevent individual authorities from pursuing investment strategies most appropriate for them.

Do you have any additional comments about this option?

Long term sustainability of the SLPGS is not about investment costs alone. The SLPGS make up is somewhat different to the E&W LGPS. The SLPGS is made up of only 11 Funds with the largest Fund by far making up approx. 50% therefore following E&W down the pooling route is not necessarily the best option for Scottish Funds i.e. potential cost savings if any would not be to such a scale and therefore would not justify such a radical shift, when all evidence to date shows the current Scottish Model is working very successfully.

Cost savings could instead be made through development of internal resources leading to greater in-house investment management and reduction in external fund manager fees to support sustainability in the long term.

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?*

See answer under pooling

- *What would be the positive impacts?*

As above – no clear wins for NESPF

- *What would be the negative impacts?*

Loss of local accountability – ability to determine asset allocation, investment strategy at a local level.

Higher salary costs in terms of recruiting and retaining more experienced individuals to manage larger scale investment funds.

Significant costs, time and resources of merging and sheer complexity of implementing.

- *If merging were possible, under what circumstances should a fund consider a merger?*

Mergers should only be considered on a voluntary basis.

- *Under what circumstances should the SLGPS consider directing funds to merge?*

As above – merging should not be prescriptive.

Governance:

- *What impact do you think mergers between funds would have on governance?*

Impact is difficult to anticipate given lack of clarity on what final model would look like.

- *What would be the positive impacts?*

Potential for streamlining of governance and reduction in duplication – however this would come at the cost of loss of local accountability.

- *What would be the negative impacts?*

Loss of local government accountability which would have a detrimental impact on members and stakeholders, as currently members of the Pensions Committee are locally elected Councillors.

Strong possibility that larger Funds would struggle administratively, thereby failing to meet statutory functions as well as suffer from lack of local knowledge should merged

Fund(s) be centralised. NESPF has invested considerable time and resources (by setting up a dedicated employer relationship team) developing relationships with our employers and the results of this hard work can be seen through the high quality data we receive monthly, strong administrative performance, an ongoing understanding of individual funding/covenant issues, training provision etc.

Difficulty in selecting host authority – associated costs/challenges and risks of redesigning scheme infrastructure to support.

Operating risks:

- *What impact do you think mergers between funds would have on operating risks?*

Economies of scale would mean greater risk, with much bigger investment decisions requiring increasingly complex governance and higher scrutiny levels.

- *What would be the positive impacts?*

Potentially stronger voice for stakeholders

Reduced key man risk in particular for smaller SLGPS Funds.

- *What would be the negative impacts?*

Complexity – time, resources and getting right expertise to see any benefit in the long term would be extremely challenging. Such a radical change in structure and way of operating poses an extremely high operating risk in the pursuit of unknown cost savings.

Infrastructure:

- *What impact do you think mergers between funds would have on funds' ability to invest in infrastructure?*

NESPF already has 10% allocation to infrastructure.

Possible economies of scale may open up further investment opportunities but conversely may also close down other smaller opportunities leading Funds to invest in more riskier/less familiar opportunities. Either way need to be 'good' investments for the Fund (fiduciary duty would be first consideration) and there would likely need to be a wider supporting strategy in place (like in the Australian model).

- *What would be the positive impacts?*

As above

- *What would be the negative impacts?*

Ultimately the long term objective of the Fund is to achieve a rate of return on investments to allow the Fund to meet the liabilities of members. An overriding focus on infrastructure is limiting, risky and could go against the Funds ultimate fiduciary duty to employers and members.

Do you have any additional comments about this option?

Ultimately dismantling a system that is working well as demonstrated by extremely positive funding levels at 2017 valuation.

Day to day administration is already extremely complex, with multiple sets of regulations to apply, and merging the Funds opens up likelihood of risk of errors/omissions e.g. incorrect payments and reputational risk. Although there is the likelihood of a more consistent administration service for members and employers, this does not ultimately mean they will receive a better service. There are far simpler ways to achieve this through collaboration and co-operation across the 11 Funds to develop a more consistent approach.

Potential redundancies for in-house pensions teams which may be significantly detrimental depending on age and service profiles of staff leaving.

Potential loss of local Pension Fund Offices would mean members would no longer have option to meet/discuss pensions issues in person – growth in digital communication means the importance of face to face communication can often be underestimated.

Large numbers of employers in the merged fund(s)– would lead to disconnect between employer and scheme.

Question 5: Preferred and additional options

The text can wrap onto additional pages.

a) Which option does your organisation prefer? Please explain your preference.

North East Scotland Pension Fund wishes to retain the status quo, but with greater collaboration and co-operation with other Funds. As such, we are happy to assume a lead role in any future projects to facilitate this.

b) What other options should be considered for the future structure of the LGPS?

Other solutions are available currently which would result in medium term cost savings. Further investigation should be given to Lothian Model – which would see greater in-house investment management and the reduction of external fund manager fees.

c) 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 above

d) Are there any other comments you would like to make?

We feel that the story of the SLPGS is one of considerable success and we see no reason why long term sustainability, as the primary focus, can not be achieved by smaller incremental changes by greater collaboration and co-operation across the 11 Scottish Funds.

The consultation questions end.