Department for
Communities and
Local Government

Call for evidence on the future structure of the Local Government Pension Scheme

Government response to the call for evidence

May 2014
Department for Communities and Local Government

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1. Government response to the call for evidence

1.1 This paper sets out the Government's response to the call for evidence on the future structure of the Local Government Pension Scheme which ran from 21 June to 27 September 2013. It provides a high level summary of the key themes raised under each question and attempts to capture the wide range of sometimes contradictory views expressed by respondents. It also outlines the fund specific data, wider evidence and opinion cited by respondents in support of their arguments. In addition to this paper, the Government has responded to the call for evidence by publishing a consultation on principles for reform, which provides fuller details of the Government's proposals. You can access this consultation at https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.

Background to the call for evidence

1.2 In 2010, the Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission to review public service pensions and make recommendations on how they might be made more sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers. Lord Hutton's final report was published on 10 March 2011. In the report he highlighted the collaborative approach being taken by funds within the Local Government Pension Scheme and recommended that the benefits of co-operative working be investigated further.

1.3 Recognising the scope for potential savings to the Scheme, the Department hosted a round-table event to consider these issues with the Local Government Association in May 2013. The objectives for reform identified at the round-table fed into the call for evidence on the future structure of the Scheme which ran over the summer. This asked respondents to consider how the administration, structure and management of the Scheme might be reformed to reduce fund deficits and improve investment returns, as well as cut investment fees and administration costs, strengthen the availability and quality of in-house resource, and improve the flexibility of investments. The responses were shared with the Shadow Scheme Advisory Board, which provided the Minister for Local Government with its recommendations and analysis of the responses. A copy of this analysis is available from the Shadow Board's website at http://www.lgpsboard.org/index.php/structure-reform/board-analysis-menu.

1.4 In addition to the responses to the call for evidence, the Government's consultation has been informed by both the recommendations of the Shadow Board, and further analysis commissioned by the Minister for Local Government and the Minister for the Cabinet Office using the Contestable Policy Fund. This detailed analysis was undertaken by Hymans Robertson who was asked to examine three proposals: creating 5-10 merged funds, establishing 5-10 common investment vehicles or setting up one common investment vehicle. The analysis, which identified scope for savings of up to £660 million each year, set out the costs and benefits of each option;

the time required to realise savings; and the practical and legal barriers to implementation. A copy of the Hymans Robertson report is available at https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.

2. Summary of responses and proposals

2.1 133 responses to the call for evidence were received in total, over half of which were from local authorities with scheme manager responsibilities; 69 of the 89 funds in England and Wales submitted a response. 35 responses were from firms working in the pensions industry, four from trade unions and Scheme members, and 12 from other representative bodies. The majority of respondents recognised the benefit of some change, although there was less of a consensus about the type of change needed.

Q1. How can the Local Government Pension Scheme best achieve a high level of accountability to local taxpayers and other interested parties – including through the availability of transparent and comparable data on costs and income – while adapting to become more efficient and to promote stronger investment performance?

2.2 The responses to this question focused on two key themes about how best to achieve a high level of accountability, transparency and governance across the Scheme: maintaining the link to democratically elected councillors, and improving the transparency of data.

Maintaining the link to local councillors

2.3 The Shadow Board's analysis indicates that 70 respondents, 53 of which were fund authorities, highlighted their concern over the loss of local accountability. It argued that there was a strong role for democratically elected members in taking decisions on the investment strategy, investment management and administrative matters, based on advice from officers, actuaries and independent advisors. The ability to set a tailored investment strategy and determine the asset allocation locally was seen as especially important amongst respondents from both the public and private sectors. Respondents argued that the link to elected councillors is necessary to hold the funds to account, as the deficit in any fund will ultimately fall to local taxpayers. Indeed, an increase in deficit will lead to higher contribution rates that may be funded either through an increase council tax or reduced services.

2.4 Some respondents also suggested that it would be unfair to merge funds because each fund has developed its own historic deficit or funding level that should be addressed locally. They argued that merging funds could impose a reduced funding position on better funded schemes.

2.5 Finally it was seen as crucial by some respondents that funds should be accountable to both employers and members. In particular, they suggested that as employers have individual contribution rates, they need assurance that their assets are ring-fenced from inappropriate intervention. These submissions argued that as the number of Scheme employers continues to grow, their representation is more easily delivered at the local level through adequate employer representation on investment committees. In the same vein, many were concerned that merging funds would reduce accountability as governance would no longer sit in the communities in which the fund operates.

2.6 However, a smaller number of respondents suggested that maintaining the link to local councillors did not add to fund accountability and questioned whether this needed to be maintained. Since pensions are not commonly featured on the agenda of most local elections, some felt we should question the extent to which the funds are truly accountable to local taxpayers, especially where the fund covers several authorities. Others suggested that funds could make greater use of professional specialists in directing scheme governance to reduce the impact of political interests on investment decisions.

The Government recognises that local determination of a fund’s asset allocation was seen as a vital consideration amongst respondents to the call for evidence. A common investment vehicle could be designed to allow asset allocation to remain at local fund authority level, consistent with ensuring that decisions are taken in line with existing local accountabilities.

Data needs to be more comparable. This will improve transparency

2.7 Many respondents, and fund authorities in particular, drew attention to the volume of reports and data produced about the Scheme. This includes the compulsory, audited accounting reports and the optional benchmarking activity undertaken by most funds with the Chartered Institute of Public Finance and Accountancy and the WM Company. However, whilst they recognised that data is available, many respondents also argued that the current quality of data could be improved. Indeed, one respondent highlighted a case where a fund appeared to report the same item differently in two separate data sources.

2.8 Whilst split on the effectiveness of the current reporting arrangements, the majority of respondents agreed that the data provided needs to be comparable in order to improve decision making, accountability and transparency. Further discussion about the types of data required and how best to collate and analyse it is provided under question five.

Q2. Are the high level objectives listed those we should be focusing on and why? If not, what objectives should be the focus of reform and why? How should success against these be measured?

Are they the right objectives?

2.9 The call for evidence cited two primary objectives; dealing with deficits and improving investment returns. Although very few responses rejected the objectives outright, many felt that they could be improved or clarified.

2.10 In particular, many respondents argued that both objectives should be considered in the context of investment risk and sustainability. Several indicated that care was needed when pursuing “improved investment returns” or “reduced deficits” as they could be achieved using methods detrimental to the funds in the long term. For example, deficits could be reduced through higher contribution rates, but this may make the fund unsustainable for employers in the long term. In addition, two responses emphasised that investment returns can only be improved without taking excessive and potentially inappropriate risk, if performance to date has been sub-optimal. As such, several organisations suggested that the objective be rephrased to focus on “managing deficits” through realistic deficit recovery plans, rather than “dealing” with them, in part to discourage excessive risk and volatility in improving investment returns.

2.11 Whilst the majority of respondents agreed that deficit reduction is important for the funds, several commented that it was unlikely to be delivered through structural reform. Responses from both the public and private sector also argued that deficit reduction was already a priority for funds, with some seeing it as more of a means of ensuring the long term stability and durability of the Scheme.

What should be the primary objectives?

2.12 Whilst the exact phrasing around what the primary objectives should be differed across the responses, the following themes were prevalent:

- Ensuring the long term sustainability of the Scheme, including stable membership.
- Developing strong governance arrangements and better decision making for all funds.
- Achieving a fully funded scheme and lowering the burden on council tax payers.
- Delivering stable contribution rates for employers and employees.
- Being able to pay pensions and benefits as they fall due.
- Improving risk adjusted returns.
- Achieving value for money, with a focus on quality as well as cost.

The Government believes that all of these objectives listed, including reducing fund deficits and improving investment returns, can be seen as facets of the first bullet point: ensuring the Scheme is sustainable in the long term. For example, the Scheme will be more sustainable if it is affordable – achieving a fully funded scheme will help to reduce and stabilise the cost to employers, employees and council tax payers, as well as ensuring that benefits can be paid on time. Improving risk adjusted returns and securing value for money in the Scheme administration and management will help the Scheme move closer to being fully funded. Higher returns and better value for money are more likely to be realised if funds have strong governance and decision making arrangements in place.

The Government has therefore focused on this overarching objective, of long term sustainability, in developing its consultation and proposals for Scheme reform.

How should success be measured?

2.13 The majority of responses focused on how the funds might be evaluated and their individual performance measured, rather than how the success of any structural reform programme might be analysed.

2.14 Both private and public sector responses suggested a range of measures of fund performance. These included:

- How the funding level or investment performance improves compared with the actuary's forecast or the fund's long term deficit reduction plan (that is, evidence the deficit is reducing over time);
- Credibility of deficit reduction plans;
- Affordability of contribution rates;
- Reduced calls on council tax; and
- Strength of cash flow.

2.15 Other less popular suggestions were focused on administration costs, such as comparing unit costs per member. A few focused on governance and stability, for example using a measure of reduced manager turnover to assess performance.

2.16 Although the measure suggested differed, most respondents focused on a mechanism for assessing a fund's deficit. One organisation went further than most, suggesting that the funds could follow the private sector model, where annual recovery plans are submitted to the Pensions Regulator and those forecasting recovery over more than 10 years subject are to additional scrutiny.

2.17 Around 10 public and private sector organisations referenced the impact that changes in the gilt market can have on deficits. Some argued that market volatility over time should be considered, rather than a funding level judged on one day every three years.

Q3. What options for reform would best meet the high level objectives and why?

2.18 As the Shadow Board identifies in its review of the call for evidence, very few responses discussed how to manage fund deficits. The Shadow Board went on to recommend that it support the Government by developing a shortlist of feasible options for managing deficits and conducting further research into the costs and benefits of the key options for reform.

The Government agrees that opportunities to improve funding levels should continue to be explored and looks forward to considering the Shadow Board's proposals for alternative ways of managing deficits. The consultation also welcomes views on how deficits might be managed.

2.19 The majority of both public and private sector respondents instead focused on how to address the secondary objectives; particularly reducing investment and administration costs through more efficient management.

2.20 Several respondents argued that a range of options for reform should be available to funds, since each has their own funding position, cash flow and membership profile. Many felt that any Government proposal should be adopted on a voluntary basis;

with others suggesting that the Government should offer further support to existing examples of collaboration and other initiatives looking to improve efficiency and performance. Some argued that only those unable to demonstrate improvement or who consistently perform poorly should face compulsory mergers or collective investment vehicles, whereas others recognised the need for wider participation in order for any proposal to generate significant savings.

Is bigger better?

2.21 Many respondents elected to address this section by discussing the advantages and disadvantages of mergers and common investment vehicles; with the latter proving considerably more popular. Additionally, many respondents highlighted the importance of collaboration, procurement frameworks and strong governance in meeting the objectives. However, a key issue discussed by most respondents was the extent to which size delivered benefits for the funds.

2.22 There was a lot of contradictory data and opinion expressed in the call for evidence about the correlation between fund size and performance. A mixture of fund specific evidence, international evidence and academic papers were referenced by respondents when engaging with this topic. A list of the most commonly cited academic papers is available on the Shadow Board's website http://www.lgpsboard.org/index.php/structure-reform/responses-public-view#Annex3.

2.23 A small number of submissions, predominantly from private sector organisations, argued that bigger funds performed better, pointing to the following research and evidence:

- A paper from the Rotman Institute showing larger international funds outperforming smaller ones by 0.43-0.50 per cent per year.
- Evidence that Scheme funds which are greater than £10 billion generate higher returns and experience less volatility than smaller schemes.

2.24 In contrast, several respondents cite evidence to show that there is no correlation between fund size and performance. One organisation included a chart showing the annual investment returns achieved across all Scheme funds by fund size over the last two decades, which indicated that performance does not appear to be affected by fund size; with some smaller funds out-performing larger funds.

2.25 On balance, the evidence available suggests that there is no conclusive link between investment returns and fund size, but that there may be other advantages of scale. Several respondents provided evidence of larger funds harnessing lower investment and administration costs. Indeed, one private sector organisation looked at 12 Scheme funds of around £8 billion and found investment and administration costs as a percentage of asset value decreased with size. This view was also shared by the Shadow Board following their analysis of the call for evidence, who argued that:

> The evidence appears to show indirect benefits of larger fund sizes, although any direct link between fund size and investment return in the Local Government Pension Scheme is inconclusive.

2.26 A number of the responses and reports highlighted significant benefits to scale such as increased use of internal management, greater diversification of asset classes and managers, and a more responsive governance structure. As such, a number of submissions argued that where evidence has suggested larger funds perform better; this may be largely attributed to these other characteristics commonly found in larger funds; and which smaller funds or common investment vehicles may also harness.

How to achieve scale?

2.27 Having set out the case that there are significant benefits attributable to scale, particularly in terms of cost reduction, respondents discussed the relative merits of mergers and common investment vehicles as mechanisms for attaining this scale.

2.28 The following arguments were raised in favour of mergers being the best option for reform, although the case was made by only a few respondents overall:

- Larger funds brought about by mergers are better able to reallocate resources to attract the right investment professionals and pay them sufficiently; building up their in-house resource and enabling them to secure lower costs.
- Others stated larger funds will deliver economies of scale in investment and administration costs. They argued that increased scale generates collective bargaining power to negotiate lower fees with fund managers, especially in the more expensive alternative asset classes.
- Some respondents who were not generally in favour of mergers still argued that they could be pursued either between small funds located close to each other, or in cases where clear governance or financial maladministration is shown to have occurred.

2.29 However, mergers were more commonly mentioned in the context of their drawbacks by respondents from all sectors. Key arguments against mergers included:

- Mergers are likely to have very high transition costs with further cost benefit analysis needed to understand exactly how much.
- Mergers will require substantial resources and time to implement effectively.
- There are potential risks to the Scheme and market of concentrating the fund too heavily and moving such large amounts of assets.
- Many underlined the difficulty of cross subsidising weaker funds and how to merge them with better performing ones.
- Roughly 15 respondents noted that merging funds would not tackle deficits.
- 23 respondents, mainly from the private sector, raised the issue of constrained capacity if funds were merged. Two investment firms cited examples of their own policy of closing investment strategies before they get too large to manage effectively.

2.30 Instead, many across the sector argued that the benefits of a merger might be achieved more quickly, simply and economically through common investment vehicles. Around 75 of the 133 respondents supported common investment vehicles or the ‘pooling of assets’ as an option for reform. Further benefits in relation to the secondary objectives are discussed under question four. Key arguments included:

- Common investment vehicles should deliver most of the cost reduction benefits of mergers but they can be realised more quickly; not least because setting up the vehicles does not require primary legislation.
- Common investment vehicles can harness economies of scale in the same way as mergers, for example through increased bargaining power on fees.
- This approach would allow authorities to maintain the direct link to accountable, elected councillors, seen as fundamental by most respondents.
- Others noted how this option still allows for different deficit positions and recovery periods; so that each fund can take into account the profile of their liabilities when determining their funding strategy.

Having considered these points and Hymans Robertson’s cost benefit analysis, the Government has decided not to consult on fund mergers at this time. Nevertheless, there remains a strong case for achieving economies of scale and other benefits through the use of common investment vehicles, and the Government plans to consult on this basis.

Governance

2.31 Although discussions around reducing deficits were limited, many fund authorities suggested that improving governance arrangements would have a significant benefit.

2.32 A few used this to argue that structural reform was unnecessary as they saw good governance as the key to both tackling deficits and improving investment returns.

2.33 Some respondents proposed that the best means of improving governance centred around greater scrutiny of the funds, with suggestions of how to do this ranging from a light touch regulatory regime based on standard codes of practice and guidance, to setting up regional scrutiny boards akin to Ofsted for schools to share expertise and avoid unnecessary duplication. Others felt that the governance proposals set out in the 2013 Act already serve as a strong model, by introducing local boards and a national scheme advisory board which can take a long term strategic focus and encourage the sharing of best practise.

2.34 Conversely, some submissions argued that existing and proposed governance arrangements do not go far enough, as the whole system needs to be professionalised. One private sector organisation suggested setting up a permanent, professional investment committee to manage investments, with elected officials still setting the long term strategy. Others pointed out that larger schemes (through common investment vehicles or mergers) can access better governance; drawing on international evidence that suggests the success of pension funds in Canada and the Netherlands is largely down to their size which has freed up resource to invest in a robust and dedicated governance structure.

Following the responses to the informal governance discussion paper which was published in June 2013, and as required under the 2013 Act, the Government plans to consult separately on governance with draft regulations later in the spring.

Procurement frameworks and collaboration

2.35 The use of procurement frameworks and collaboration more generally was cited by around 85 of the 135 respondents as a positive option for reform. Most respondents sought to highlight the benefits they have experienced of using frameworks, with some promoting this as a stand alone option, regardless of any other reforms which may be taken up. It was generally felt that the Government should lend its support to collaboration initiatives already underway. More discussion on this option can be found under question four in relation to achieving the secondary objectives.

Q4. To what extent would the options you have proposed under question 3 meet any or all of the secondary objectives? Are there any other secondary objectives that should be included and why?

Are these the right objectives?

To reduce investment fees

2.36 A number of respondents suggested that the inherent focus on gross fees was not helpful in this objective. They suggested that it took little account of the differences between active and passive management, arguing that higher fees may be justified if growth can be linked directly to manager performance. A number of ideas were proposed to deal with this:

- Name of objective should be changed to ‘improving value for money’
- Fees should be explored against risk adjusted returns

2.37 Some respondents also argued that the potential for savings under this objective are limited since Scheme fees are already broadly comparable with the global benchmark; particularly on core mandates such as passive products, bonds and equities. One organisation mentioned that whilst most managers offer a tiered fee structure which reduces as assets grow, the majority of this benefit is achieved once assets reach around £500 million, and hence there would be little merit from a cost reduction perspective of pooling assets beyond this level.

2.38 However, a few respondents noted that more complex arrangements such as “fund of fund structures” drive higher fees. Since a number of funds use these structures to invest in alternative asset classes, it was suggested that the scope for savings may be more significant here.

2.39 In addition, a number of respondents cited analysis by Hymans Robertson published shortly before the call for evidence closed which showed that fees were broadly comparable with the global benchmark, particularly on listed assets such as bonds and equities. Some respondents went on to suggest that passive management may help to reduce investment fees, rather than structural reform. They discussed the potential cost savings and decreased risk that could be achieved by greater use of passive management across the Scheme, questioning whether active management is appropriate for traditional asset classes and whether the returns justify the fees.

Two local authorities referred to evidence of significant fee reductions resulting from their use of passive management, although others were keen to demonstrate their use of active management to achieve good rates of return over longer periods, and presented some fund specific examples of this.

The Government believes it is possible to significantly reduce investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market. The Government therefore plans to consult on this option, and on maintaining the use of active management for alternative asset classes through a common investment vehicle. Please refer to the consultation document for full details.

To improve the flexibility of investment strategies

2.40 Many submissions argued that the investment regulations are currently too restrictive, hampering the return opportunities and risk management of Scheme funds and prohibiting appropriate investment strategies. Specifically, they place restrictions on the amount of a fund that can be invested in certain types of vehicle, for example limited partnerships in aggregate are subject to a limit of 30 per cent. The issue of rigidity in the investment regulations was underlined in around 16 submissions.

2.41 Respondents suggested various ways to improve investment flexibility; with the most popular being to reform the investment management regulations. Some submissions also suggested that the greater size of a pooled or merged fund may enable recruitment of better quality investment professionals who could form an investment committee; streamlining decision making and improving access to complex hedging strategies and risk management tools. Others felt flexibility could be improved through the use of frameworks with pre approved managers to reduce the time lost between investment decisions being made and subsequent implementation.

The Government recognises that the investment regulations are in need of review. The Department will consult separately on reforms to these regulations, which will be developed in light of the consultation on structural reform.

To improve the cost effectiveness of administration

2.42 Amongst those who commented on administration reform, which was generally taken to mean aggregating administration services, many were quick to point out how any savings will be marginal in comparison with investment costs. Several responses suggested the scope for savings was limited, for example because administration costs were already low, or because authorities already used the same IT system. Respondents also argued that since costs were driven by the number of members and employers, savings would be minimal as this would not change under a merged administration. In addition, many were keen to highlight the potential loss of local links with employers and local accountability; making it harder for example, to hold local surgeries with employers and deliver face to face support for scheme members. Similarly they noted the risks of reforming administration, increasing the risk of incorrect payments and associated difficulties; especially in light of the new 2014 Scheme being introduced in April generating increased complexity.

2.43 In contrast, some respondents suggested that savings could be found. They argued that larger funds are able to achieve lower administration costs, citing a mixture of personal evidence and tables derived from the Department's statistical data set relating to the Scheme (SF3 data) to demonstrate this. For example, one shared service venture set out that it had saved £500,000 per annum by reducing staff and accommodation costs, ending outsourcing, using greater automation, introducing consistent processes, and creating a single database, with member and employer self service. Another fund analysed a sample of admin costs from 100 Scheme funds over three years to show that larger funds have administration costs that are on average, £5-£25 per member lower than smaller funds each year.

The call for evidence has highlighted the scope for potential administrative efficiencies as well as the associated risks. At this stage, the Government proposes to allow the administration arrangements for the 2014 Scheme to mature before considering reform any further.

To provide more in-house investment resource/access to higher quality staffing

2.44 A number of submissions stressed the potential benefits of in-house management and access to higher quality staffing, citing a mixture of their personal experiences and international evidence to support their argument. For example, 28 responses referenced State Street analysis which concluded that in-house management was more cost effective for larger funds and may lead to better investment performance outcomes, whilst Canadian public sector pension funds were used as a peer comparison in six responses as evidence of successful in-house management due to the size of the funds. Some pension fund authorities and one professional body also included data demonstrating that the Scheme's internally managed funds outperformed those externally managed by 80 basis points per annum over the 10 years to 31 March 2012 (50 basis points over 20 years).

2.45 Nevertheless, several submissions also pointed out the risks of in-house management, including the difficulty arising from restrictive local authority pay scales that may not allow for these specialist roles to be filled by sufficiently experienced staff. Following on from this, one fund authority underlined how external providers offer specialist skill and research capabilities, particularly for active management and alternative assets, which are very difficult for in-house providers to match. Another fund also noted that for passive management the economies of scale achieved by the major external providers and the technical skill required to track benchmark indices makes in-house management impractical.

To enhance investment in infrastructure

2.46 Many respondents took issue with the focus on enhancing investment in infrastructure as an objective for reform, with some suggesting it could enable local politicians to invest in local infrastructure projects which may not serve the long-term interests of the Scheme. It was argued that investments should only be made following an appropriate assessment of anticipated returns relative to risk levels, and that the objectives should not encourage investment in one particular asset class. 47 of the 133 submissions espoused this view.

2.47 A minority of respondents in favour of increased investment in infrastructure highlighted how a super pool would achieve the scale to enable funds to directly access alternative assets such as infrastructure, without the high fees associated with “fund of fund” arrangements. Conversely, some did not see fund size as a restriction to infrastructure investment. One fund authority cited their own experience of having agreed and implemented two infrastructure investments with two unlisted infrastructure managers, despite being small.

How would the following models deliver these objectives?

Shared Services/Frameworks

2.48 A number of joint procurement framework initiatives are currently underway. It was broadly felt that frameworks saved time and money when procuring specialist pension fund services; leveraging the combined buying power of the Scheme whilst still meeting local requirements and accountability. The use of frameworks specifically was mentioned by around 34 respondents, 25 of which were local authorities; although the benefits of more general ‘collaboration’ were also discussed in most responses.

2.49 The most frequently mentioned benefit of frameworks in relation to achieving the secondary objectives was significantly reducing the cost of administering funds and procuring services. The National LGPS Frameworks presented evidence of one fund that paid £4,000 to procure an actuary through their framework compared to an estimated £30,000 to £40,000 for a full procurement process. Moreover, the National LGPS Frameworks claim that procurement timescales have been reduced from 6-12 months to 4-8 weeks as the frameworks are already compliant with EU regulations and contain pre-agreed terms and conditions. In addition, respondents suggested that sharing resources under collaborative working or joint procurement may facilitate the retention of existing high quality staffing resources.

Although there are clear benefits to using frameworks, the scale of savings achievable through them does not match those possible through more substantial reform such as the use of common investment vehicles. However, the Government believes that there is an important role for procurement frameworks to play in delivering savings for the Scheme and is keen to see this opportunity taken up by more of the funds.

Common investment vehicles

2.50 A majority of respondents commenting on this question were keen to detail the ways in which asset pooling through common investment vehicles would meet all or most of the secondary objectives: Key points raised include:

- Investment fees should be lowered by economies of scale through co-investing, and this will be more noticeable in the more expensive alternative asset classes such as infrastructure and private equity.
- Funds could still retain the flexibility to hire their own managers where they felt this might produce superior returns.
- Increased collaboration through the common investment vehicle may serve as a platform for future collaboration or mergers in administration services.

- If the vehicle is managed by a lead local authority or a local authority shared service, then collaboration through it should improve resilience and access to higher quality staff, as the host authority would employ staff with appropriate expertise who can then offer services to other funds. Eventually this could lead to a build up of in-house management expertise; although this was not always felt to be appropriate as an objective.

Q5. What data is required in order to better assess the current position of the Scheme, the individual Scheme fund authorities and the options proposed under this call for evidence? How could such data be best produced, collated and analysed?

2.51 As discussed under question one, there was a general consensus that the current data is not designed to guide strategic decision making, with 94 of the 133 respondents highlighting their concern over this. Respondents felt that this process could be made be more prescriptive to enable like for like comparisons and develop a realistic understanding of the current position of the Scheme.

2.52 Under this question respondents discussed who the responsible body should be that produces and analyses the data, how the data can be made more comparable and transparent, and finally what additional data should be collected to enable this.

Who should be responsible for producing and analysing the data?

2.53 No consensus was reached as to who should be the responsible body that produces and analyses Scheme data. However, there was cross sector agreement that funds should be required to participate in any approach taken to improve transparency. Key suggestions included:

- The Department should continue to compile its statistical release about the Scheme, but the guidance notes should be improved and expanded, to ensure comparability between funds
- The Government Actuary's Department and the Chartered Institute for Public Finance and Accountancy could produce a standardised approach, after which the Department could analyse the data
- A central resource such as a national Scheme Standards Compliance Team could be established to work with the scheme advisory board to drive up data quality, consistency, standards and efficiency.
- Data could be collected and analysed by the Shadow Board, who could then advise the Secretary of State.
- An online data room or questionnaire could be used to capture points of interest, which could then be collated and analysed by a review body.
- CEM Benchmarking could be used across the Scheme to provide benchmarking analysis.

How can the data collected be made more transparent and comparable?

2.54 Most organisations suggested more detailed guidance or industry standards for data returns, publications and policies, to ensure a consistent approach was taken, especially for identifying administration costs and investment fees.

2.55 In terms of presentation, the vast majority of submissions suggested that all data should be published online to increase transparency, including triennial valuation statements and performance targets comparable to fees. Some fund authorities favoured a league table approach with the lowest performing quartile having to publically justify their position, after being given an opportunity to challenge draft data before it is published; thereby increasing public accountability.

2.56 It was widely recognised that the range of actuarial bases currently used renders factors such as risk tolerances, funding levels and contribution rates very difficult to compare. However, the benefit of using different actuarial valuations is being able to reflect each fund's particular circumstance, including their membership profile and deficits. It was suggested that consistent assumptions provided by the Government Actuary's Department would help develop comparable data, although this approach would not recognise the aforementioned reasons why the assumptions might differ in the first place. A range of proposals were made to address this issue:

- Run two valuations – one with fund specific assumptions to set employer contribution rates and a second to deliver comparable data.
- Make a comparison between funds of similar levels of maturity or investment strategy.
- Detail should be published on the main assumptions used and sensitivity analysis done to show the impact of changes in those assumptions.

2.57 In terms of investment and administration costs, respondents were concerned over their clarity and transparency. Currently the funds report an overall figure for investment costs and then for administration costs to the Department, but these are not broken down further to distinguish between different investment strategies and approaches. For example, there is no distinction as to whether a passive or active investment strategy has been followed, or whether the funds are externally or internally managed. It was suggested that collecting more detailed information should improve the transparency of fund data. The data suggested to be collected is listed in paragraph 2.59.

2.58 In addition, respondents noted that investment costs are very difficult to compare across funds. To make this comparison easier, some submissions suggested using a standard measure of basis points relative to assets under management. Others were keen to point out that each fund is subject to their own particular circumstances and choose to follow different strategies which lead to different fee levels. Some respondents were concerned that a standard measure of basis points relative to assets under management might be used to guide towards a common low cost strategy, and instead emphasised that investment costs should be seen in the context of whether the fund has achieved its objectives and required investment returns.

What additional data should be collected?

Investment and administration costs

2.59 Respondents suggested a range of measures that could be collected to improve the transparency of investment and administration costs, as well as investment performance. These included:

- More detailed administration costs, broken down into the main component parts and assessed against a range of quality measures;
- Asset management fees paid for each investment mandate, such as an asset class, and per each investment in a pooled fund
- Fees paid to investment consultants, independent advisers and custodians;
- The investment returns compared to their target, broken down by each investment mandate over several time periods to compare manager performance
- Performance assessed against a standard measure and then adjusted for different types of investment strategies.

2.60 In addition to determining standard costing methods for administration and investment fees, one organisation also suggested that administration costs arising from working with multiple employers should be examined. Many funds spend considerable time and money fulfilling the role of the employer, for example by tracking down missing member data. These costs are not consistently charged to employers and should be made clear.

Position of fund:

2.61 Respondents also suggested the following data should be publicised to make the position of each fund more transparent:

- Funding level of each fund and the Scheme in aggregate, including key underlying assumptions such as mortality rates and ill health rates.
- The data used by funds' actuaries to determine the current funding level and employers' contributions, for example the discount rate used and the anticipated rates of return underpinning the assumed necessary investment return
- Investment returns net of investment fees
- Cash flows reported on a consistent basis

The Minister for Local Government has asked the Shadow Board to look at data transparency in more detail. It has already made progress, bringing together all of the funds' annual reports on their website. The Government is keen to support the Shadow Board in this work and looks forward to working with it to ensure more comparable data is available in the future.