

## **Local Government Association**

### **Response to**

## **INVESTMENT CONSULTANCY SERVICES AND FIDUCIARY MANAGEMENT SERVICES**

### **MARKET INVESTIGATION**

#### **Statement of issues**

#### **Status of response**

1. This response is submitted on behalf of the Local Government Association in its capacity as the representative body of local authorities whose employees (and those of connected bodies) constitute 78% of the membership of the Local Government Pension Scheme. The LGA's membership includes 84 of the 88 scheme administering authorities.
2. The LGA also acts as secretariat of the Local Government Pension Scheme Advisory Board, however, this response is not in that capacity and therefore may not be attributed in whole or part to the Board or as representing the views of the Board as a collective.

#### **General**

#### **The Local Government Pension Scheme (LGPS) in England Wales**

3. The LGPS in England and Wales (the scheme) represents over 5m members with over £240bn in assets as at March 2017 making it one of the largest in Europe. It is also the largest funded public service pension scheme in the UK the other significant funded schemes being the LGPS in Scotland and the LGPS in Northern Ireland.
4. The scheme is statutory rather than trust in nature and is managed by 88 administering authorities the vast majority of which are local authorities each of which is required to maintain a pension 'fund' which is ring-fenced for the purposes of collection of contributions, investment, meeting of administration costs and the payment of benefits.

5. Although not operating under trust law, the scheme places statutory duties, in the areas of funding and investment, on administering authorities which are in many ways analogous to those of trustees. In the majority of authorities these duties are delegated to a committee of elected members (councillors), assisted by local pension boards with scheme member and employer representatives, and supported by officers and a range of advisors.
6. Authorities are required by regulation - The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 - to take proper advice when formulating their Investment Strategy Statement which must include—
  - a) a requirement to invest fund money in a wide variety of investments;
  - b) the authority's assessment of the suitability of particular investments and types of investments;
  - c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;
  - d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
  - e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
  - f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

To assist administering authorities in preparing these policies, the Department for Communities and Local Government published statutory guidance in September 2016.

## Assets used by the scheme

7. The scheme invests in a wide range of assets and vehicles as shown in the table below taken from the scheme annual report 2016 and representing the total asset values at that time <http://lgpsboard.org/index.php/investment-2016>.

Asset class	Asset type	£000s	%	£000s	%
Fixed interest	Fixed interest UK	7,633,795	3.5%	10,554,872	4.9%
	Fixed interest Overseas	2,921,077	1.3%		
Index-linked	Index-linked UK	4,946,377	2.3%	5,718,862	2.6%
	Index-linked Overseas	772,485	0.4%		
Equities	Equities UK	32,532,367	15.0%	75,099,382	34.7%
	Equities Overseas	42,567,015	19.7%		
Pooled Vehicles		94,630,676	43.7%	94,630,676	43.7%
Property	Pooled Property	10,477,407	4.8%	16,942,688	7.8%
	Direct Property	6,465,281	3.0%		
Other				14,028,183	6.5%
Total				216,974,663	100%

## Source of investment advice in the LGPS

8. The table below show the source of investment advice in the scheme and is based on information contained in over half (45) of the authority annual reports and accounts.

Source of advice	% of authorities
In House only	4.4%
Single regulated firm only	55.6%
Multiple regulated firms	4.4%
Single regulated firm plus Independent adviser/s	20%
Independent adviser/s only	15.6%

9. It should be noted that in all cases, officers would provide support with regard to decision making however, only two of the 45 authorities researched stated explicitly in the annual report that their in house team provided investment advice.

10. Of the regulated firms the number of clients of each, based on the 45 annual reports, was as shown below

Firm	Number of clients
Mercer	9
Aon Hewitt	6
Hymans Robertson	10
Allenbridge	6
Deloitte	4
Others	3

11. Three annual reports stated explicitly that a change of investment adviser had taken place in the last 12 months although others may have done as this is not a requirement for the report.

## Responses to particular views sought in the statement

12. We believe the scope and issues identified in the statement are broadly correct and therefore do not intend to comment on all areas. However we would wish to make comment on the following areas:-

### *Difference in size and type of pension funds*

13. Although the LGPS funds are amongst the largest in the country they vary in size between under £1b and over £21b and this is reflected in the different levels of resource and expertise available. Although there exists a body of academic evidence of a linkage between fund size and levels of governance and performance there are also instances of very well run smaller funds with excellent performance records. Therefore we would ask that any survey not start with a presupposition that bigger is always better.

### *Importance of the role of trustees*

14. While the LGPS does not have trustees as such, we agree that the ability of those elected members who perform the scheme's statutory duties and the local pension board members who assist them are central to its success. In particular, the scheme has an issue in developing and more importantly retaining skills in this area due to the democratic and political nature of elected member appointments.
15. Furthermore, the scheme has an interesting dichotomy in that members of the local Pension Board, a body set up in statute but responsible for 'assisting' in but not delivering the statutory management duties are required to attain a level of knowledge and understanding under regulation. Whereas the elected members who do have the statutory duty to deliver the management function have no such requirement in regulation. However, there is a clear expectation that elected members with investment responsibilities will acquire knowledge and understanding and are encouraged to adopt the learning package offered by the CIPFA.

16. Local authorities are currently in the middle of dealing with a change from professional to retail investor status under MiFID II. Part of this process is gathering of information on the experience and training of elected members. The CMA survey could usefully use such information rather than request it separately and the LGA would be happy to assist in that process.

### ***Conflict of interest***

17. Although there is no implicit evidence of conflicts operating to the detriment of investors there are consultants in the LGPS who offer fiduciary management services and therefore we would welcome an independent review into how well potential conflicts are managed. However, any methodology which attempts to measure the impact of such conflicts risks being by nature subjective. In our view it would be better to improve the opportunity for and knowledge of elected members and/or officers to effectively test the independence of views expressed by the consultant.

### ***Undue influence of consultants***

18. Again there is no implicit evidence that consultants in the LGPS exert undue influence over investment decisions made by the authority. Indeed it would be difficult to prove that such influence has determined a decision in a way that it would not otherwise have been made.
19. Where the consultant is potentially unchallenged due to the lack of available resource, expertise and experience within the authority, the risk of such influence can be high. However, it is our view that it would be better to improve the resource, expertise and experience within the authority to ensure it can effectively test the views of the consultant rather than seek to in some way measure the extent and effect of undue influence.

## **Responses to potential remedies**

20. We believe the remedies identified in the statement are broadly correct and therefore do not intend to comment on all areas. However we would wish to make comment on the following areas:-

### ***Transparency of fees and charges***

21. We believe that greater transparency in this area would lead to increased competition. This hypothesis has already been put to the test in the LGPS via the Scheme Advisory Board (SAB) Code of Transparency for asset managers <http://lgpsboard.org/index.php/structure-reform/cost-transparency> . This code includes a standard template, developed with the Investment Association, for the reporting of fees and charges in a regular and consistent manner.

22. The introduction of transparent reporting has been received by many managers as an opportunity to gain a competitive edge and has enabled some LGPS authorities (in particular West Midlands) to reduce fees markedly.
23. This has now been taken up by the FCA by the formation of the Institutional Disclosure Working Group on which the LGPS has representation and which is seeking to create industry standards for transparent disclosure of fees and charges across a range of asset classes.
24. Either the work of the IDWG could be extended to include consultants or a similar body could be formed to produce appropriate standards. Such disclosure should pick up the issues regarding consultant's fees within manager costs and gifts and hospitality.
25. The SAB code will include the passing of detailed template data to a third party for analysis and checking and for high level cost data to be available for benchmarking. As such we would support similar third party involvement in this area.

#### ***Increased levels of consultant reporting and disclosure***

26. We would guardedly welcome increased reporting from consultants in the areas of fee savings and performance of selected managers against benchmarks provided it did not increase consultant fees significantly or reduced the time available for their primary role. As stated above measures which seek to prove the independence of the consultant risk being subjective and in this case potentially costly.
27. We do welcome the recommendation to require consultants to fully disclose all business interests both within their own firm and with asset managers. It is a standard which authorities should meet and therefore it should extend to their advisors.

#### ***Increased duties and professionalism of trustees***

28. The responsibility to ensure probity of decision making in the LGPS lies with elected members assisted by local pension boards and supported by officers. Anything which improves their ability to do so is to be welcomed. As stated above, developing and maintaining effective levels of knowledge and experience can be difficult especially if there is no regulatory requirement to do so.
29. Therefore a requirement for enhanced mandatory training for trustees which included authority elected members would be welcomed. In this respect it may be useful to determine DWP's intentions with regard to the forthcoming IORP II 'fit and proper' requirement for those managing pension schemes. This requires a sufficient collective level of knowledge, expertise and qualifications across the trustees.
30. Authorities have a duty to ensure value for money in their dealings therefore a specific duty for the scheme would fit within such an environment. Care would however need to be taken to ensure that value is not determined solely by cost.

31. The requirement for at least one professional ‘trustee’ would provide a level of knowledge, expertise and consistency to LGPS authorities, however, care would need to be taken to ensure the status of elected members in authority decision making is not impaired. An alternative could be a requirement for the appointment of an independent investment advisor in addition to the consultant (as currently in place in 20% of LGPS authorities in England and Wales).

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26<sup>th</sup> October 2017.