<u>Agenda Item No: 9</u>

CAMBRIDGESHIRE PENSION FUND

PENSION FUND BOARD

26 June 2014

Report by: THE HEAD OF PENSIONS

Subject:	**Draft response to the Department for Communities and Local Government (DCLG's) consultation on opportunities for collaboration, cost savings and efficiencies in the Local Government Pension Scheme (LGPS) .**
Purpose of the Report	To update the Pension Fund Board on the consultation on the future structure of the LGPS and how it invests its assets.
Recommendations	**That the Pension Fund Board:** **1) Notes the attached draft response to the consultation; and** **2) Delegates to the Section 151 officer in consultation with the Chairman and Vice Chairman of the Pension Fund Board the completion and submission of the final response.**
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1. Background

1.1 On 1 May, the DCLG released the long awaited consultation in response to the call for evidence on the future structure of the LGPS and how funds should invest their assets. The consultation is titled: *Consultation on opportunities for collaboration, cost savings and efficiencies in the Local Government Pension Scheme (found at https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies).*

1.2. It focuses on passive investments and the use of Common Investment Vehicles [CIVs]. The crux of the debate revolves around the headline £790 million per annum that the DCLG believe can be saved by investing through collective investment vehicles and moving all active listed securities mandates (equities and bonds) into passive management.

1.3 Five consultation questions were asked in the consultation. They are:

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

Q3. How many common investment vehicles should be established and which asset classes' do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

1.4. Question 5 above also had 4 supplementary questions detailed below:

1. Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.

2. Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments**.**

3. Fund authorities could be required to manage listed assets passively on a "comply or explain" basis.

4. Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in the consultation paper and the Hymans Robertson report.

1.5. The most obvious explanation for these options being proposed is a response to the numerous academic and empirical studies which show that the 'average' active manager has, after fees, underperformed the index over most periods of time. Supporters of passive management point to this as evidence that active management does not add value.

1.6. The flaw in this argument is that it refers to the 'average' manager. Apply the same logic to other walks of life: the average golfer does not win the Open Championship, the average writer does not pen a classic and the average painter can't be expected to produce a masterpiece. So why should anyone anticipate high investment returns from the average fund manager?

1.7. The case for active management rests on avoiding the average manager. If we took out the value added net of fees that Majedie, UBS UK equities, Schroders UK Equities etc have added to the two funds, they both will be in a much worse position with regards to funding levels and deficits.

1.8. There are also other considerations around passive investing including the fact that investing in a benchmark is not without risk and there is significant value in avoiding large parts of the market that passive investors blindly hold. For example, the technology bubble of the late 1990s and the recent banking crisis provide painful evidence of the risks attached to blindly tracking the market.

1.9. The attached appendix details the fund's draft response to the consultation. This is being submitted as a joint response from LGSS on behalf of the Northamptonshire and Cambridgeshire Pension Funds.

The closing date for consultation responses is 11 July 2014.

2. Recommendation

It is recommended that the PFB note the attached draft response to the consultation and delegate to the Section 151 officer in consultation with the Chairman and Vice Chairman the completion and submission of the final response.

3 Relevant Pension Fund Objectives

Perspective	Outcome
Funding and Investment	To ensure that the Fund is able to meet its liabilities for pensions and other benefits with the minimum, stable level of employer contributions. To ensure that sufficient resources are available to meet all liabilities as they fall due. To maximise the returns from its investments within reasonable risk parameters.

4 Risk Implications

Risk(s) associated with the proposal

Risk	Mitigation	Residual Risk
The review of the future structure of the LGPS needs to be done very carefully and any decisions implemented properly. Any dislocations from any of these proposals are likely to have a long lasting negative impact on the LGPS and will be difficult to unwind.	We have drafted the response in consultation with external advisers and managers. We have also supported our responses with evidence and logical, clear answers.	**Red**

Risk(s) associated with not undertaking the proposal

Risk	Risk Rating
The DCLG do not consider the issues, risks and opportunities around collectivisation nor the value added net of fees by properly governed active management and as a result imposing restrictive regulations to the detriment of funding levels and costs passed on to employers and ultimately the tax payer.	**Red**

5. Communication Implications

None at present.

6. Finance & Resources Implications

None at present.

7. Legal Implications

None at present.

8. Consultation with Key Advisors

Information has been provided by the funds managers and advisers.

9. Alternative Options Considered

None

10. Background Papers

None

11. Appendices

Appendix 1 - Draft response to the DCLG consultation

Checklist of Key Approvals.	
Is this decision included in the Business Plan?	Yes
Will further decisions be required? If so, please outline the timetable here	Yes – this will depend on the DCLG's next step.
Is this report proposing an amendment to the budget and/or policy framework?	No
Has this report been cleared by the Relevant Director?	Yes – cleared by Chris Malyon, Head of Finance and Section 151 Officer.
Has this report been cleared by the Head of Pensions?	Yes Steve Dainty, Head of Pensions
Has this report been cleared by the Section 151 Officer?	Yes – cleared by Chris Malyon, Head of Finance and Section 151 Officer.
Has the Chair of Pensions been consulted?	Yes
Has this report been cleared by Legal Services?	Yes, Laurie Gould