Nottinghamshire County Council

Report to Pensions Sub-Committee

16 July 2013

Agenda Item:8

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

NAPF LOCAL AUTHORITY CONFERENCE 2013

Purpose of the Report

1. To report on the NAPF Local Authority Conference 2013.

Information and Advice

2. The NAPF Local Authority Conference 2013 was held on 20th to 22nd May 2013 at the Cotswold Water Park Four Pillars Hotel. In accordance with prior approval and as part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills, the conference was attended by Nigel Stevenson (Group Manager – Financial Strategy & Compliance) and Simon Cunnington (Senior Accountant – Pensions & Treasury Management). No members of the Sub-Committee attended as the date of the conference fell before the first meeting of the newly constituted Nottinghamshire Pension Fund Committee following the County Council elections in May 2013.

3. ***"Sometimes things become possible if we want them bad enough"***
   This fringe session, preceding the main conference and hosted by John Finch from JLT Benefit Solutions, focused on a survey undertaken by JLT of local authorities that were attending the conference. The survey asked about the relative importance of various factors over the next 10 years.

4. Mr Finch seemed surprised that achieving 100% funding was seen as unimportant, as this is top priority for virtually all private sector schemes. This reflects the statutory nature of the Local Government Pension Scheme (LGPS) and the covenant strength of the major employers. Positive cashflow was viewed as very important to respondents and these two views remained unchanged throughout the 10 year survey period. There was a major change, however, in the importance of greater collaboration between funds. This was seen as unimportant currently but became the most important within 5 years. Some respondents may have changed their current view on this issue over the course of the conference.

5. Mr Finch finished the session with JLT's forecasts of returns over the next 10 years. Highest returns were expected from private equity, emerging market equities, developed market equities and property (ranging from 8.5% to 7% pa) although he believes that EM growth will increasingly be accessed through

developed market equities. Lowest returns were expected from Gilts, both traditional and index-linked (1.7% to 2.4% pa).

6. ***The new LGPS***
The main conference began with Brandon Lewis MP, current Minister for Local Government. He outlined the rationale for the ongoing reforms to the LGPS and stated that consultation will shortly be launched on the administration and governance elements of these changes. He praised the enviable record of administration within the LGPS but pointed out that little has changed since 1974. Investment management and administration currently costs £500m per year and most agree that this needs to reduce.

7. Mr Lewis stated that we need a more complete assessment of funding levels and deficits and suggested the possibility of moving towards a cashflow model of funding. He also called for a 'root and branch' review of the investment regulations. His most contentious statements, however, were regarding the possibility of fund mergers where he outlined a call for evidence but stated that he was 'not wedded to having 89 funds'. This review would form part of the workload of the new Shadow Pensions Board, set up as part of the changes to governance introduced in the Public Service Pensions Act 2013.

8. ***Implementing LGPS 2014: from here to go-live***
This session began with Chris Megainey, Deputy Director – Workforce, Pay & Pensions at the Department for Communities and Local Government (in his own words, the new Terry Crossley), apologising for the new regulations not yet being finalised. A consolidated set of regulations was expected soon with consultation to begin in June. This, however, still wouldn't include the governance elements or anything on Fair Deal.

9. Rodney Barton, from the West Yorkshire Pension Fund, followed with a pragmatic practitioner's viewpoint. The new scheme will need more detailed information in order to calculate benefits and will include protected rights that need to be managed for many years. Under a CARE scheme, accurate data will be needed each year, rather than just at retirement, and annual benefit statements will become increasingly important to enable members to challenge data accuracy. System changes will be key, but the later the regulations are finalised the more difficult these changes will be to implement. Staffing resources will become even more stretched and those authorities who have cut staff may find themselves with serious difficulties.

10. The session finished with Brian Strutton from the GMB union who concentrated on the governance changes under the Public Service Pensions Act 2013. Although these changes won't be fully implemented until 2015, a shadow Scheme Advisory Board is being set up now. This board is responsible for providing advice to the Minister and will be involved in recommending employee contribution levels and other cost measures under the new scheme. Its members will include employer representatives (from the LGA), member representatives (from the unions) and advisory members from administering authorities and actuarial firms.

11. ***All Change: employer security and the new LGPS***

The final session of the first morning featured three speakers discussing the issue of employer risks within the new LGPS. Clillfford Sims from Squire Sanders outlined the 'tools' to manage employer risk: security in case of failure, early warnings and investment segregation. Mark Packham from PwC outlined the private sector approach where employer covenant was evaluated in detail at each valuation and monitored in between. This is important as the strength of covenant can affect the deficit and the additional cash contributions required.

12. Kevin McDonald from the Essex Fund talked through their approach to assessing employer risk following the failure of two employers. The fund's actuary, Barnett Waddingham, had carried out an assessment of each employer and plotted these on a risk chart to give a clear indication of which employers were most at risk. This allowed early discussions to be held with these employers to help prevent further failures and maximise income to the fund.

13. ***The 2013 valuation: the story so far***
Conference favourite, Ronnie Bowie, filled the after-lunch slot with a look at the expected results from the 2013 triennial valuation. Since 2010, assets have increased but bond yields have fallen so the funding level overall is expected to have reduced from 75% to 70%. The new scheme will reduce the cost for most employers by up to 2% but some employers, particularly with a higher proportion of older employees, will face *increases* of up to 4%. Any employer with a funding level below 60% will need additional cash contributions.

14. ***Balancing the books: financial management in the LGPS***
Brendan Mullkern and Clive Lewis explained the Universities Superannuation Scheme's (USS) financial management plan. The USS is a multi-employer scheme but with a common contribution rate across all employers. Their plan has three strands which all interlink – employer covenant, investment strategy and funding. The plan involves detailed assessment of the major employers' strength and also considers downside risks, giving options to address these if they arise.

15. ***Investing for the future: what needs to change?***
Nigel Keogh from CIPFA was clear in his view that the LGPS investment regulations need to be revised further. The issues of main concern are the investment limits and the lack of clarity over definitions, particularly derivatives. The former predated other risk measures that have since been put in place and so are now out of date. The latter has lead to funds incurring unnecessary costs on legal advice.

16. Nick Buckland from Dorset gave an example of the regulations increasing costs. Following a strategic review of asset allocation, the Dorset fund decided to use inflation hedging. This involved derivatives but, as it was believed these were not allowed in a segregated mandate under the regulations, a special pooled fund had to be created.

17. ***Too big? Too Small? Just Right?***
The final session of day one was a lively debate between Edmund Truell, new chairman of the LPFA, and Nicola Mark, Head of the Norfolk Pension Fund. Mr Truell began by extolling the virtues of fund mergers, suggesting there should be

one fund for London and 5 regional funds for the rest of the country. This would have a number of key benefits including:

- Access to better liability management
- Economies of scale in investment management and administration
- Access to long term investment opportunities
- Direct investment in infrastructure and private equity
- Reducing external advisers and increasing in-house expertise

18. Nicola Mark reminded delegates that Hutton had recommended against fund mergers and that last year's minister had clearly said 'no mergers'. She contrasted the long term nature of the LGPS with the short term tenure of ministers in charge of it. There appears to be a wider agenda and a desire to hurry through changes but this forgets the many efforts that are already being made, with little central support, to improve the cost and efficiency of the administration of the LGPS.

19. ***Can we afford it?***
Day two began with David Smith, an economist from the Sunday Times. As we approach the 6th anniversary of the financial crisis, world trade has recovered and is growing, driven mainly by emerging economies. Developed economies still have a debt hangover and are recovering much more slowly than in previous recessions. The Eurozone in particular is struggling as the crisis has added to the area's existing fiscal problems.

20. Mr Smith gave his outlook including:
    - Low interest rates until 2016
    - Gilt yield are unsustainably low but depends on quantitative easing (QE)
    - May be more QE but likely to be more radical options from the new Bank of England governor
    - Inflation is higher than earnings growth so consumer recovery will be slow

21. ***Investing for success: chasing return in a low growth world***
Roy Nolan from LB Newham and Peter Wallach from Merseyside gave their views on options for investment returns apart from traditional equities. These included 'smart beta' funds that invest passively against non-market cap weighted indices and 'low volatility' funds where stocks are chosen based on their risk-return profiles. The latter had been more positive than the former. The Merseyside fund also includes an 'opportunities' portfolio that gives flexibility to make investments that don't fit within the normal classes.

22. ***Driving excellence: good governance in the LGPS***
Andrew Warwick-Thompson, the Pensions Regulator (TPR) outlined how he is engaging with the LGPS in advance of the changes to be brought in by the Public Service Pensions Act 2013. TPR has been the regulator of all work-based pensions since the Pension Act 2004 but has previously given no real attention to the LGPS. This will change in 2015 when TPR gains the specific role of oversight of administration and governance. In advance, TPR is building a team and is likely to publish codes and guidance covering knowledge and understanding, conflicts, records and controls.

23. ***Short-term politics and long-term decision making***
The conference concluded with Daniel Finkelstein, Executive Editor of The Times who presented some theories to help politicians. He claimed that most people don't care about politics and often don't understand it. But this shouldn't lead to a cynical view – what matters to people is the real things: how much better off they are and when; their experience of services. Most have a desire to fit-in, preferring to deal with those who are similar. He ended on a note of caution warning that most people are happy to put in more than they get out but feel aggrieved if others are getting something for nothing.

Statutory and Policy Implications

24. This report has been compiled after consideration of implications in respect of finance, equal opportunities, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That it be noted that attendance at key conferences is part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills.
2) That the report be noted

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Background Papers
None