Nottinghamshire County Council

Report to Pensions Sub-Committee

21 June 2012

Agenda Item:6

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

NAPF LOCAL AUTHORITY CONFERENCE 2012

Purpose of the Report

1. To report on the NAPF Local Authority Conference 2012.

Information and Advice

2. The National Association of Pension Funds (NAPF) Local Authority Conference 2012 was held on 21 to 23 May 2012. 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 Councillors Cox and Rigby and Mr Simon Cunnington (Team Manager – Investments).

3. Two sessions were attended prior to the first day of the main conference. The first was entitled 'Liability Driven Investing (LDI) – targeting pension scheme funding volatility'. The speaker argued that all funds use a form of LDI by managing their funding position without necessarily trying to match the liability cashflows. The main purpose of LDI is to capture improvements in funding levels by reducing risk at the appropriate time and hedging unrewarded risks. However, hedging has a number of difficulties:
    - Insufficient index-linked bonds in the market and none linked to CPI
    - Usually involves swaps which continue to be problematic for local authorities
    - Longevity swaps have few counterparties available and usually only cover pensioner members (rather than active and deferred members)

    One inflation hedge that most local authority funds do hold in significant amounts is equities.

4. The second session looked at alternative ways of investing in UK property including real estate finance and ground leases. Global property financing was previously dominated by banks but this is reducing following regulatory changes that are forcing correlation of banks' capital with asset risk. Insurance companies tend to provide 'senior' debt which leaves a gap for investors in 'junior' debt (accessed through fund vehicles). Ground leases are long leases (average length 250 years) granted by landowners to developers in return for annual payments. At the end of the lease (or if the ground rent is not paid) the lease and any buildings on the land revert to the landowner.

5. The main conference started with Anthony Hilton, Financial Editor of the Evening Standard, recalling the recession of the 1970s. He suggested that this was worse than now and encouraged attendees not to worry too much about the Euro, debt levels and government cuts. He argued that Europe has always been a strong Germany and weaker southern nations but overall was economically viable; using debt to pay for things over generations was nothing new (eg war bonds); and governments generally freeze expenditure before increasing again rather than making real cuts. He did however warn about the lack of economic growth and the negative impact of quantitative easing. He suggested that an economy doesn't function with very low interest rates and a rate increase would actually give a positive message.

6. The next speaker was Sir Merrick Cockell from the Local Government Association (LGA) who had wanted to outline the main features of the new Local Government Pension Scheme (LGPS). However, as agreement between the negotiating parties had not quite been reached, he outlined instead the process of negotiation. The LGA's objectives were to ensure a sustainable and affordable scheme, to minimise opt-outs and to encourage younger members to join. The tri-partite process (LGA, Communities and Local Government (CLG) and Unions) had involved regular meetings and all parties had been genuinely committed to reaching agreement.

7. Two sessions followed entitled respectively 'De-risking: the devil is in the detail' and 'The Currency Iceberg'. The first looked at how and when to de-risk asset allocation. Risk can be reduced by diversifying growth assets by sector, region and into alternative asset classes. Further de-risking can only be done when fully funded but it is important to monitor this and be ready to act when the opportunity arises. The second session stated the typical currency exposure of a UK fund as 67% sterling, 19% US dollar, 7% Euro, 4% Japanese Yen and 3% other currencies. Sterling was strongest against world currencies in 1990 but weakest in 2008 and hedging should only be undertaken when currency was weak. However, difficulties in forecasting future currency movements meant the case for hedging appear flawed.

8. The first session after lunch considered liquidity in the LGPS. Peter Morris from the Greater Manchester Pension Fund has projected falls in active members to 2014 leaving a smaller membership from which to recover deficits. He identified further risks to the scheme from a wider range of employer profiles with higher risk of failure with the result that his fund is working much more closely with employers. Ewan Cameron Watt from BlackRock outlined the multiple challenges of declining membership, longevity, equity risk and artificially low interest rates. With low real returns, volatility needs to be managed to reduce the risk of big losses, and 'diversified growth' strategies can help.

9. The next session was entitled 'Automatic Enrolment – what do you need to know?'. Automatic enrolment will be phased in from October 2012 and will place a duty on LGPS employers (rather than the administering authority) to keep records of all employees who have opted out of the scheme. These employees will have to be re-enrolled every three years. Employers will also have to register with the Pensions Regulator within four months of their staging date. The LGA will be

sending a briefing document to each administering authority for distribution to all employers within the LGPS.

10. 'Value for money – where does it come from?' examined a number of initiatives to collaborate on procurement within the LGPS. David Anthony from the Wiltshire pension fund outlined how the funds within the south west region had worked together to produce two framework agreements (for legal advisory services and actuarial, benefit and investment advice). The process needed very close liaison and was incredibly time and resource intensive. Nicola Mark from the Norfolk fund then presented the first National Framework for actuarial and benefit consultancy. This will be open to all LGPS funds and is hoped to be followed by a number of other framework agreements.

11. Three speakers then presented their views on 'Project LGPS 2014'. Jeff Houston from the LGA emphasised the negotiated nature of the process with the aim of avoiding conflict and reassuring members. He stated that 99% of the proposals had been agreed with all parties keen to finalise the remaining issues. Terry Crossley from CLG described the likely regulatory process involving informal consultation on the proposals and then formal consultation on the draft regulations in autumn. The regulations need to be in force by 30 March 2013 in order for actuaries to be able to take them into account in the next valuation exercise. Mike Taylor from the London Pension Fund Authority suggested that the outcome of the negotiations was largely known apart from the accrual rate and revaluation factors. The big issue is increased complexity and this is likely to need system changes.

12. The next two speakers concentrated on infrastructure investment. Geoffrey Spence from Infrastructure UK (part of HM Treasury) stated that infrastructure investment was needed to rebalance and 'de-carbonise' the economy and to facilitate growth over the medium term. A number of financial tools previously used to finance infrastructure are no longer available so new sources of investment are needed. The government needs to be proactive to remove barriers to investing but has no desire to 'raid' pension funds. Joanne Segars, chief executive of NAPF, outlined the Pensions Infrastructure Platform being developed by NAPF in association with a number of large funds. The aim is to provide dedicated expertise and ensure deals are structured to the advantage of the investors. The suggestion is for a fund of approximately £2 billion to invest mainly in the UK with 10 to 12 founder funds providing half of the capital.

13. The conference was closed by Bob Neill MP, Parliamentary Under Secretary of State at CLG, with the promise that an agreement on the new LGPS was due within days. This promise was kept as details of the new scheme were released shortly after the conference.

Statutory and Policy Implications

14. 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 the report be noted.

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Background Papers
None