report

Nottinghamshire County Council

meeting	PENSIONS INVESTMENT SUB-COMMITTEE		
date	7 JULY 2011	agenda item number	**9**

REPORT OF THE SERVICE DIRECTOR (FINANCE)

NAPF LOCAL AUTHORITY CONFERENCE 2011

PURPOSE OF THE REPORT

1. To report back to Members of the Pensions Investment Sub Committee on the content of the annual Local Authority Conference hosted by the National Association of Pension Funds.

INFORMATION AND ADVICE

2. The annual NAPF Local Authority Conference was again held at the Belfry Conference Centre in Warwickshire (16-18 May 2011). The conference was attended by Mr Paul Simpson (Service Director). The theme of the conference was “A new day: Local Authorities look to the future” and a summary of the main presentations is set out in the following paragraphs.

3. Joanne Segars, Chief Executive of NAPF welcomed delegates to the conference stating that the coalition government has been busy in regard to pension reform and in particular Lord Hutton’s review which will have far reaching implications for local government. She stressed the need for honesty in regard to the media’s portrayal of public sector pensions and the important role NAPF had to play in supporting local authorities in getting the message across. She went onto to outline the broad thrust of the changes and the importance of communication with employees, particularly in relation to selling a Career Average Scheme, and the proposed increase of 3% in contributions, which could lead to employees opting out altogether. She concluded by highlighting the lack of clarity in terms of the process for implementing Lord Hutton’s reforms and called for the government to take urgent action to clarify the proposed implementation deadline of 2015.

4. The first keynote address was from Bob Neill MP, Parliamentary under-Secretary of State, Communities and Local Government. Mr Neill’s presentation focused on the government’s localism agenda and the role of the LGPS. He began by reminding the conference of the challenging time within the public sector and for public sector pensions, given the demographic pressures and the implications this has for long

term funding. He affirmed the government's commitment to the 'Big Society'; of returning power to communities and elected representatives and believed that the LGPS fits well with this agenda i.e. that local authorities should be looking to report to local communities on their activities rather than to central government, and in particular how public money is being spent. He acknowledged the work of elected members, officers and fund managers in managing the LGPS and gave his commitment to his department continuing to work alongside local authorities to maintain transparency. The main thrust of his address, though, focused on the need to resolve the financial challenges and highlighted the fact that employers' contributions have risen from £1.5bn in 2000/01 to £6.2bn in 2009/10. On this basis he argued that it was, therefore, only reasonable to expect employees to make a contribution to their pension costs but acknowledged the potential impact of employees opting out.

5. The Minister also set out a challenge to reduce scheme operating costs; across the 89 separate LGPS funds, he claimed that total expenditure on administration and fund management was £400m. He announced that a number of highly significant projects are underway to identify how savings can be achieved through better procurement, and encouraged authorities to find ways of working together more effectively. He concluded by re-affirming the challenges ahead, that the government was committed to the LGPS remaining a defined benefit scheme but that it had to be affordable, sustainable and fair.

6. Following the keynote address the next session, looking at the future of the LGPS, involved Ronnie Bowie of the Institute and Faculty of Actuaries, and Brian Bailey of the West Midlands Pension Fund. Mr Bailey focused on the recommendations of the Hutton review, and stated that broadly he considered it a reasonable outcome, although there remained significant challenges and uncertainty, in particular the target implementation date of 2015. He then focused on 3 of the recommendations that he considered potentially problematic:

   - The need for primary legislation by 2015 which by its nature would be complex and, therefore, would the government adequately resource its production?
   - There needs to be a Treasury led consultation on the broad design principles – how will a centrally led consultation apply to the different schemes, in particular the underlying cost assumptions?
   - Removing access to non-public sector workers and the implications this might have for future outsourcing deals.

7. Mr Bowie presented a series of slides on the funding levels of the LGPS and the levels of investment return that would be needed to "make the numbers stack up with the greatest degree of uncertainty". He also thought the 3% increase in employees' contributions was a "bad idea" and argued for a smaller increase (say 1%) and a lower accrual rate. He was also of the view that any savings to the exchequer as a result of the changes would be simply taken away in reduced grant funding to local authorities.

8. The session after lunch was entitled “Is bigger always better – or can small still be beautiful”. 3 speakers, Richard McIndoe from Strathclyde Pension Fund, Colin Meech of Unison and Mark Packham of PricewaterhouseCoopers, gave some opposing views on the case for and against consolidation of the LGPS.

9. Mr McIndoe was firmly in the smaller is better camp. His case was based on a pathfinder project in Scotland which looked at 11 funds and how they might be managed in the future. He stated that it is not easy to run a big fund, primarily due to the complexity of the governance and funding, and that economies of scale are only helpful to a point. In terms of the whether there was any correlation between size and performance, the project suggests not and that the best performing fund was the smallest. He concluded that they were likely to back off any large scale merger in Scotland, with the focus being on improving fund performance and greater collaboration and co-operation.

10. Unsurprisingly Mr Meech was of a different view, and he referred to the work Unison had undertaken through its “Protect our Pensions” project. They commissioned APG (the internal fund managers of the Dutch equivalent to the LGPS) to undertake research and to look at the performance of funds and evidence for the merger of funds across the LGPS. The research looked at 10 years of LGPS data, such as cashflow, fund performance and management costs and mapped it against an international benchmark. They identified that the 4 best performing schemes (out of 101) were the largest. They then carried out a hypothetical exercise to create funds of the same size of the 4 largest, which resulted in 14 “merged funds”.

11. The analysis suggested that if the performance of these 14, had matched the performance of the top 4, it would have resulted in £9.6bn more in asset returns, £1bn less in fund management costs and asset values would have increased by 1/3rd. He equated this to an increase for an ordinary pension member of £5,616. The amount realised by such a merger, would in Unison’s view equate to £1.2bn, which is more than the £900m the Treasury is looking for in terms of savings and would have avoided the need for the proposed 3% increase in contributions. He finished by highlighting the point made in Hutton’s report for the need to identify incentives for merger, and that two such incentives from a Unison perspective, were the need to avoid strike action and that members would quit the scheme, on the grounds that they could no longer afford to make the contributions.

12. Mr Packham as the third of the speakers took the middle ground and suggested the answer to merger was probably “maybe”. Mr Packham referenced the work he had done with the 8 Welsh LGPS schemes, which had examined how they could work together more effectively, with a particular focus on administration and investment. He reiterated some of the tried and tested arguments in favour of consolidation, namely greater capacity, a bigger budget so the scope to pay for better investment advice and the ability to attract specialists and potentially manage investments internally. He had also analysed data the Audit

Commission had used in a review of the LGPS and categorised the size of funds between:

- Large - those with assets in excess of £2bn
- Mid-range – between £1bn - £2bn
- Small – less than £1bn

13. This analysis revealed that over the period 2001 – 2009, the small funds had never outperformed the medium or larger funds in terms of investment return, and typically the average return of the smaller funds was 2.2% pa compared to 2.9% pa for the mid-range funds and 3% pa for the larger funds. He, therefore, concluded that there was some evidence to support a view of greater collaboration, but that it perhaps wouldn't lead to the size of savings or benefits that the previous speaker had suggested could be delivered. He welcomed the invitation from the Minister in the morning session, but warned that if authorities did not seize the opportunity, change may well be imposed from the Centre.

14. The next conference session asked the question 'A trained and competent Pension Board' do all LGPS funds meet the mark? Two speakers, Elizabeth Renshaw-Ames of Mercer and Bob Summers of CIPFA, set out their thoughts on why governance is so important and the principles and frameworks that are in place to promote it. Mr Summers asked a number of questions including:

- Have we defined the role of the Chairmen and Committee members adequately?
- Do we effectively evaluate our own performance and that of our fund managers?
- Does the authority have the capacity and competence to do the job?

15. Ms Renshaw-Ames, stressed that behaviours are critical to cognitive diversity and pointed to a lack of women Members of Pension Committees and fewer with different ethnic backgrounds. This she suggested was significant, given that multiple perspectives make good decisions. She went on to outline some of the key ingredients of a successful committee, which were:

- the quality, timeliness and amount of information available to the Committee
- the quality of the leadership, in particular from the Chair of the Committee
- the confidence, knowledge and skills of the Committee members.

16. She concluded that effective Committees do build trust and confidence and that good governance adds value to the scheme.

17. The penultimate session on day one considered how LGPS funds are adapting their investment strategies and asset allocation plans in light of the 2010 valuations. Chris Bilsland, Chamberlain of the City of

London Corporation, gave a view of an investment strategy from the perspective of a local authority Chief Financial Officer. Mr Bilsland set the scene by stating how difficult it is trying to explain to staff that their contributions would have to increase as a result of lower investment returns. This he believed would in turn mean that individual employees would become more interested in the performance of the pension fund. Ultimately, he envisaged a scenario whereby as the cost and consequences of pension changes fall more on employees that this could see a move away from employer dominated boards and committees. The outcome of these changes he believed could result in:

- A clear de-risking of goals
- Greater "simplicity" – don't invest in something you can't explain
- More employee focused schemes
- Socially responsible investment
- More visible governance.

18. He finished with the view that there would be a move towards more mergers of funds and collaborative arrangements ("safety in numbers"), and that employees would become less tolerant of perceived poor investment performance.

19. John Dickson of Hymans Robertson gave a different take on the investment strategy piece. He outlined the upward and downward pressures on pensions funds and gave a very clear view of the need to take risk in relation to an investment strategy. He explained that the probability of reaching a target funding level was very much dependent upon the valuation basis but this would be less important as the financial situation improves. He also set out the importance of the level of maturity of a scheme; the more mature a scheme is the quicker the contributions in will not be sufficient to meet the payments out. He ended by stressing the need to develop a plan that examined different risk profiles and focused on investing for growth.

20. Day one was concluded with a keynote address from Lord Hutton himself, Chair of the Independent Public Service Pensions Commission. He set out the broad thrust of his report and then engaged in a Q&A session, chaired by Nicholas Timmins of the Financial Times.

21. Day two began with an examination of the transition to the new public sector pensions system, and what is the best way to manage this. Terry Crossley a Senior Civil Servant within the Department for Communities and Local Government began by reiterating the view given by the Minister on day one regarding the underlying principles of affordability & sustainability; that a scheme should be adequate and fair; and it should support productivity and be transparent and simple.

22. He updated the conference on what has been happening since the publication of Lord Hutton's report, which included high level discussions between Ministers, Trade Unions and Senior Treasury officials. There are also scheme governance groups across all public

sector schemes and a policy review group focusing on the LGPS. All government departments are also examining the 27 recommendations of the report to assess the policy and legislative implications, advising Ministers and informing the Policy Review Group of the emerging thinking.

23. Mr Crossley also added to the debate on the challenge of the implementation deadline, and confirmed that Ministers have still to decide the detailed timetable, but that an autumn statement in response to Lord Hutton's report was expected. He speculated that one possible outcome would be that all schemes will have needed to consult on the changes, (ideally) between 1 October 2013 and April 2014, to provide a clear 12 months or so lead in time. He concluded his presentation by outlining the key actions to be undertaken to ensure the new scheme would be operational, and recognised that there is "an awful lot to do for all of us in a very short space of time".

24. The second session examined the implications of the government's monetary policy on interest rates and quantitative easing, on the long term investment needs of pension funds. John Velis of Russell Investments gave a very technical and thought provoking assessment of the UK's economic outlook. In the short term the outlook consists of:

- rising inflation
- rising commodity and energy prices
- a public deficit problem
- a tough talking Bank of England, likely to raise interest rates
- confusing UK growth prospects

25. Whilst his overall assessment of the UK's position was not particularly positive, Mr Velis did point out that despite lacklustre growth, our inflation position is probably transitory, particularly bearing in mind the impact of the VAT rise and other short term changes. He concluded, somewhat reassuringly, that whilst the economy does have some major challenges, we are certainly not Greece!

26. The final keynote speech was delivered by the well-known Guardian Columnist, Polly Toynbee. She gave an unambiguous (and not uncharacteristic) political perspective on the coalition's first year in office, and made a passionate plea in support of public sector pensions, whilst recognising the need for change. She defended the position of the pay differential between senior officers within public service organisations vis a vis the average workers pay and drew a stark comparison with the same ratio in the private sector. She commented that pensions were a direct reflection on the type of society we are. She then went on to share her thoughts on a series of issues such as the on-going challenges of reducing child poverty, which she did acknowledge could be perceived as a digression from the subject matter, but which in her opinion were relevant to the overall pensions debate. Nonetheless, whilst interesting and thought provoking, the overriding feeling was one which didn't quite chime with the general tenure of the conference.

Summary

27. The conference was clearly dominated by the impact and potential fall-out of Lord Hutton's report. Many of the speakers were generally positive about its overall recommendations but there were clear concerns, primarily the implementation timescale and also the closing of the scheme to non-public sector workers. What was repeated many times throughout the two days was however the acknowledgement, that Lord Hutton's report had avoided the so called "race to the bottom" which had perhaps been the experience in the private sector of seriously de-valuing employees' pension provision.

28. The conference was also the first attended by the new Service Director – Finance and provided him with a very useful introduction to Pensions and the significant issues and challenges that lie ahead.

STATUTORY AND POLICY IMPLICATION

29. This report has been compiled after consideration of implications in respect of finance, equal opportunities, personnel, crime and disorder, human rights and those using the relevant service. Where such implications are material, they have been described in the text of the report.

RECOMMENDATION

30. That the report is noted.

PAUL SIMPSON
SERVICE DIRECTOR (FINANCE)

Background Papers Available for Inspection

Nil