

Review of the Structure of the Scottish Local Government Pension Scheme

CONSULTATION RESPONSE FORM

Instructions

Responses in this form should be drafted in conjunction with the accompanying consultation report. To respond, please complete the **respondent details** and as many of the **consultation questions** your organisation wishes to complete and return the form via email to the Pensions Institute at consultation@pensions-institute.org no later than **Friday, 7 December 2018**.

This consultation is being conducted in electronic form only, so **responses must be emailed**; hard copy posted or delivered responses cannot be received. Any queries about the consultation should be addressed to Matthew Roy, Fellow, Pensions Institute at matthew.roy@pensions-institute.org.

RESPONDENT DETAILS

<p>Name of responding organisation(s) Please list the full name of each organisation participating in this response.</p>	<p>Organisation type Is your organisation an administering authority, employer, or employee group? Please record for each responding organisation.</p>
<p>Scottish Borders Council Pension Fund</p>	<p>Pension Fund</p>
<p>Authors Please list any people that wish to be recorded as authors of this response, including name, job title and organisation.</p>	<p>Consent Please confirm each author consents to their information being retained for analysing the consultation responses by writing 'confirm' by their name.</p>
<p>David Robertson, Chief Financial Officer Kirsty Robb Pensions and Investment Manager</p>	<p>confirm</p>
<p>Date Please date the response.</p>	<p>30/11/18</p>

Covering information

If you wish to include covering information with your response, please include the text here. The text can wrap onto additional pages if needed.

Scottish Borders Council Pension Fund

The Scottish Borders Council Pension Fund (the Fund) as part of the Local Government Pension Scheme (LGPS) is administered by Scottish Borders Council (the Administering Authority). The fund has 18 scheme employers, 4,409 active members and issued 6,575 benefit statements during in the year to 31 March 2018. The fund had 10,667 members as at 31/3/18.

The LGPS scheme is governed by the Public Service Pensions Act 2013. The fund is administered by the Council in accordance with the following secondary legislation:

- The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended)
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014
- The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015

It is a contributory defined benefit pension scheme designed to provide pensions and other benefits for pensionable employees of Scottish Borders Council and a range of other scheduled and admitted bodies within the Scottish Borders area.

Objectives

The primary aim of the fund is to

- provide for members' pension and lump sum benefits on their retirement or for their dependants' benefits on death before or after retirement, on a defined benefits basis.

The funding Objectives are to

- set levels of employer contribution that will build up a fund of assets that will be sufficient to meet all future benefit payments from the Fund.
- build up the required assets in such a way that ensure levels of employer contribution that are stable.

The latest Triennial Valuation was undertaken at 31 March 2017. The outcome of the 2017 Valuation was a funding level of 114%, an improvement in the position assessed at 2014 of 101%. The funding position equates to a surplus of over £80m demonstrating that the fund is meeting its primary objective.

On the advice of the actuary this surplus has been used over time to offset increases in the primary employer's contribution rate of 20.6%. As a result there was no change in the overall Fund common pool employer contribution rate which remained at 18% one of the

lowest employer rates in the LGPS in Scotland.

At 31 March 2018 the fund had £684.6m of assets under management, an increase of £30.2m (5.6%) on the position as at 31 March 2017.

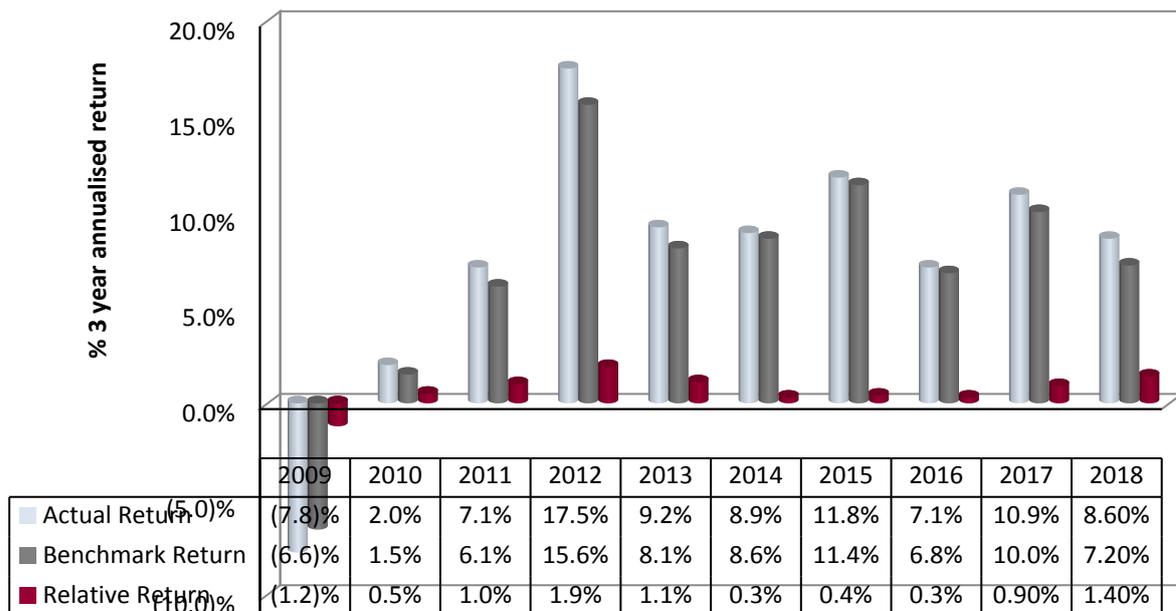
The fund has delivered strong performance of 8.6% for the rolling 3 year period to 31 March 2018.

Investment Performance

The Fund's performance against benchmark over the past 10 years is highlighted in the chart below. This chart demonstrates that the rolling 3 year annualised relative return (i.e. Fund's return achieved compared with the benchmark) since 2010 has been positive, and that over the 10 year period there has only been one year of negative returns overall for the Fund and that was immediately following the financial crisis in 2008.

On average the fund has returned relative out performance against bench mark of 0.66% per annum over the last 10 years.

3 Year Annualised Returns ending 31 March



The Fund achieved these favourable returns in 2017/18, with all Fund Managers producing a positive return. Global equities provided the highest out performance against benchmark. Relative out performance of 1.4% was achieved for the year against the benchmark of 7.2%.

Over the last 10 years the net assets of the fund have increased by 133%.

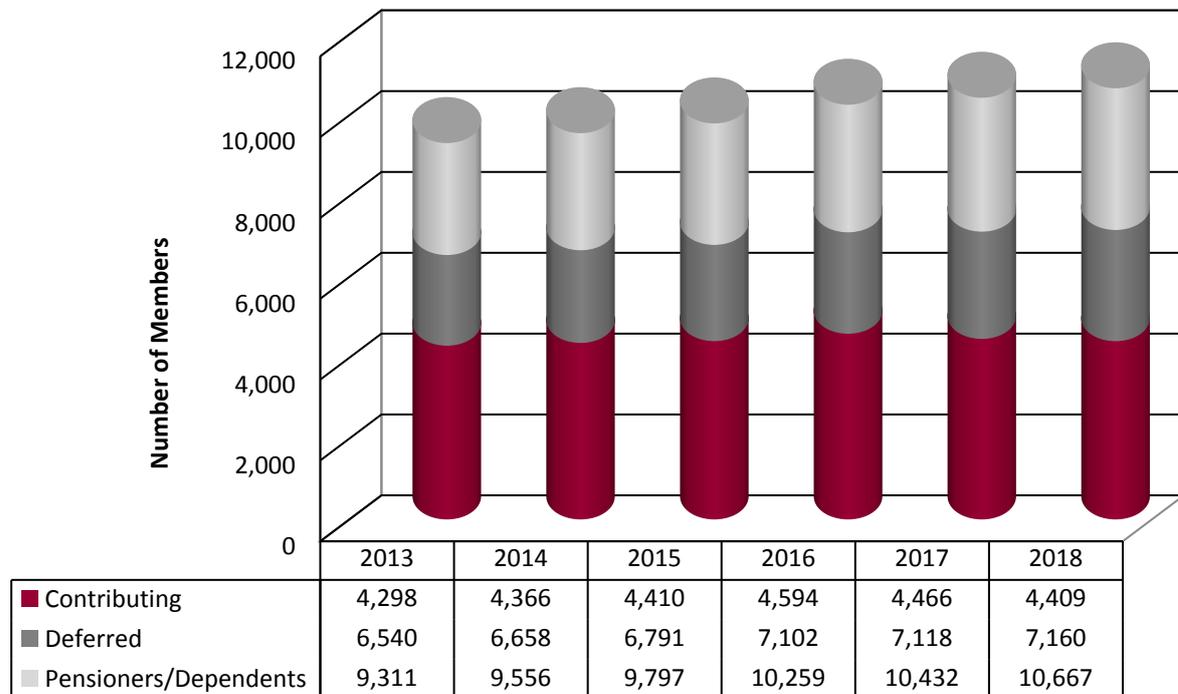
Asset Diversification

The fund is well diversified across a range of assets classes including global and UK equities, bonds, alternatives, direct lending, private credit, property and infrastructure. This latter asset class is accessed in collaboration with Lothian Pension fund. The Fund is now well positioned to withstand future fluctuations in

financial markets.

Overview of Fund Membership

Current membership of the Fund is 10,667 of which 4,409 are actively contributing and 3,507 are in receipt of pension benefits. The following chart summarises the trends in membership:



Since 2013 the total membership has increased by 1,356 members (a 15% increase overall). During this period the number of pensioners and their dependants has increased by 23%, and the number of active contributing members has increased by 3%. This presents a challenge to the Fund to ensure that it manages its future cash flows effectively as the fund matures. This was included as part of the considerations when undertaking the full investment review.

The strong asset position, along with the 2017 (114%) Triennial Valuation of funding level, demonstrates that the Fund is well placed to meet its future pension and other benefit liabilities.

Recent changes in the legislation around what pensioners are able to do with their pension benefit entitlements have increased individual freedoms to withdraw from pension funds, potentially triggering significant transfer movements. The Scottish Borders fund has not however seen any significant withdrawals as a result of this legislation and continues to monitor this position.

Governance and Decision Making

Following the significant changes required in the governance arrangements which came into force on 1 April 2015 the Scottish Borders Pension Fund Board was established. Joint

meetings of the Pension Fund Committee and Pension Fund Board have been held regularly during 2017/18.

The remit of the Pension Fund Board is to assist the Council (as administering authority) in relation to:

- a) securing compliance with the regulations and other legislation relating to the governance and administration of the Scheme and any statutory pension scheme that is connected with it;
- b) securing compliance with requirements imposed in relation to the Scheme and any connected scheme by the Pensions Regulator; and
- c) such other matters as the regulations may specify.

This body is made up of four scheme employer representatives and four trade union representatives.

The membership of the Pension Fund Committee comprises elected members from the administering authority, Scottish Borders Council.

Knowledge and Skills

The Funds Training Policy was updated and agreed on 22 June 2017. The Training Policy sets out a target for all members of the Pension Fund Committee and Pension Fund Board in relation to attendance at Committee meetings and training events. Compliance with the policy is monitored regularly.

The Policy requires members of the Pension Fund Board and Committee to attend at least two meetings per year and two training events. All Members of the Pension Fund Committee fully met the training and attendance targets set in the Training Policy. 75% of the Pension Fund Board met the attendance target and 75% met the training target. The Training policy also for 2017/18 required all members of the Committee and Board to undertake The Pension Regulator Trustee Toolkit within 6 months of becoming a member. The Fund is able to demonstrate full compliance with the relevant best practice standards and this is set out in the Governance Compliance Statement accessible at <http://www.scottishborderscouncilpensionfund.org/media/4239/annual-report-2017-18-audited.pdf>

A full copy of the Business Plan can be found at www.scotborders.gov.uk/pensions.

The Statement of Investment Principles (SIP) can be found here www.scotborders.gov.uk/pensions.

The full version of the actuary report and the current Funding Strategy is available via the Pension Funds website: <http://scottishborderscouncilpensionfund.org/>

The Fund's Pensions Administration Strategy was approved in September 2015. This sets out scheme employer and administering authority roles and responsibilities and defines the

service performance standards. A comprehensive report on Pensions Administration performance for 2017/18 was presented to the joint meeting of the Pension Fund Committee and Pension Board on 14 June 2018 and a copy of the report is available via the Council's committee papers website <http://scottishborders.moderngov.co.uk/>.

Against this background the statutory Audit for 2017/18 of Scottish Borders Pension Fund under taken by Audit Scotland concluded positively on the management of the Fund.

The Scottish Borders Pension fund is by any objective measure well managed and governed effectively. The fund is fully compliant with the relevant legislation and has well established board and committee arrangements in place. The Scottish Borders Council pension fund is 114% funded and, has a growing membership. The fund is well diversified to protect against market shocks and has recently concentrated on income yielding assets in response to the increasing maturity profile of the membership.

The Borders employer contribution rates are amongst the lowest in Scotland and the Fund complies fully with CIPFA guidance on fee transparency. The fund is assisted by appropriately qualified and experienced officers, external advisers and fund managers. It has opted up to professional status under MiFID 2 and is well placed to meet the future challenges facing the LGPS.

The SBCPF recognises that if the LGPS in Scotland was being established afresh an 11 fund structure would probably not be the model chosen to administer the fund. Nevertheless, the long track record of strong performance of the Scottish Borders Pension fund, the lack of robust evidence of the benefits of change and potentially negative impact such change will have on to the stability, performance and funding position has led the Fund to conclude that making any change to the structure of the LGPS in Scotland is an unacceptably high risk strategy.

The evidence to support change is at best selective. Pension fund reforms being undertaken in England and Wales have proved expensive and have yet to demonstrate any positive impact on fund performance.

It may be that some marginal cost savings could be delivered by fewer, larger funds over the longer term. Evidence to support this view is however again at best limited and it should be noted that some of the largest UK pension funds have recently experienced funding and governance issues.

It should also be noted that smaller scale funds, unburdened by weighty governance structures can often move quickly to access attractive niche investment opportunities. For example the Borders recently accessed a long lease property mandate which now has a six month investment queue. While economies of scale may be possible the costs associated with transitioning to new investment mandates will offset such savings for years to come.

The Fund is already investing infrastructure in collaboration with Lothian Pension fund and plans to further develop this relationship in future.

SBCPF believes that everyone should have access to high quality benefits and that the continuing high levels of engagement in the fund demonstrate continued confidence in the stability of the scheme and in the benefits of local management. This view is assisted greatly by the involvement of local elected members, local trades unions representative and local employers in the decision making process through both the

Pension fund committee and the Board.

The Fund believes that there is no reliable empirical case for change and much more work would have to be done to evaluate the benefits and significant risks associated with change before this could be supported as being in the best interests of the fund membership.

In the absence of evidence to the contrary the SBCPF is of the view that such change is likely to have a detrimental impact on performance and pensioner confidence and for this reason believes the status quo should remain while proper evaluation of the evidence supporting any change is undertaken. If change is required the Scottish Borders Pension Fund would support a voluntary collaboration model, avoiding the need for pooling or expensive, time consuming and un-proven structural reform.

The Scheme Advisory Board is respectfully reminded that the primary fiduciary duty of the LGPS is to take decisions which are in the best interests of its members. Any changes to the structure of the LGPS in Scotland must place the interests of the scheme members at the forefront of decision making. There is no evidence that the measures being considered by this consultation will deliver against this objective.

The consultation questions follow.

CONSULTATION QUESTIONS

Question 1: Retain the current structure with 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- ***How well informed do you feel about the investment costs in your fund? What information do you rely on to specify and measure these?***

The Scottish Borders Council Pension fund has undertaken a significant amount of work with its fund managers in recent years to ensure there is a full understanding of the investment costs of the fund that complies fully with the requirements of CIPFA's Guidance on Accounting for Local Governance Pension Schemes.

The Fund encourages its pension managers to sign up to the LGPS fee transparency code and fully disclose both internal and external management fees and transaction costs within its annual accounts.

- ***How well does the current system manage investment costs?***

The fund has good information with regard to fee levels allowing objective evaluation and comparison of the fees charged by individual managers.

The absolute level of cost while important is not however always the most important determining factor in retaining a fund manager. While fees levels are an important consideration the fund believes that paying additional fees to deliver out performance through active management of pension fund investments is an equally important consideration.

The fund believes that the overall value for money delivered by a manager is a more important consideration than fee levels.

The fund employs competitive tendering in the procurement of investment managers and in the procurement of other services including investment advisors, tax advice, custodian services and for actuarial services thereby ensuring best value is delivered. SBCPF uses the Norfolk Framework which is an excellent example of collaborative working across LGPS funds across the UK.

How would you improve the measurement and management of investment costs in the current system?

SBCPF already has a good understanding of the costs of investment including layered fees in our alternative mandates. All fund managers employed by the LGPS should be required to disclose their full fee structure in line with the fee transparency code.

The sharing of detailed information on fee rates per managers across all funds in England, Wales and Scotland would allow clear comparison of rates and aid funds in their discussion with Managers.

b) Governance:

How well informed do you feel about the governance of your fund? What

information do you rely on to measure this?

The SBCPF is audited on an annual basis by Audit Scotland. The 2017/18 audit of the pension fund concluded positively on the governance of the fund noting “ the fund has effective governance arrangements in place that support the scrutiny of decisions made by the pension fund committee.”

The recent advent of Pension Boards, with local employee membership, has added a further positive dimension to the governance of the pension fund.

The fund undertakes benchmarking of the outputs of the fund, including investment performance, funding level, expenses and contribution rates to assess its performance.

It publishes an annual Governance Statement under the 2014 regulations to demonstrate compliance with the governance standards required by Scottish Ministers. These standards are established via a number of best practice principles and the fund is able to objectively measure its compliance against these standards.

The fund also measures its compliance against the Myners principles which reflect best practice guidance issued by CIPFA covering the effectiveness of decision making, the setting of clear objectives for the fund, the understanding of risks and liabilities, performance assessment, responsible ownership, transparency and reporting.

SBCPF have a strong training policy which is monitored on an annual basis. All members of the Committee and Board are required to complete The Pension Regulator Trustee Toolkit within 6 months and must meet annual training requirements.

• ***How well is the current system governed?***

The 2016 KPMG review of the governance of the LGPS concluded positively with regards to the standard of governance in place across the LGPS in Scotland.

Pension Fund Boards, although only introduced in 2015, have added a further positive dimension ensuring scrutiny of pension fund committee decisions and the effective engagement of employee representatives in the management of pension funds.

Statutory external Audit of the LGPS funds is undertaken annually. These do not highlight any concerns with the current governance arrangements in place across funds.

All funds are required to comply with the requirement of MiFID 2

• ***How would you improve governance of the current system?***

The KPMG review of the system outlined no fundamental weaknesses in the LGPS governance model in Scotland.

All funds should be required to publish information regarding their investment strategy, actuarial report and funding assumptions as well as performance and key policy

documents for example the statement of investment principles or their ESG policies.

Pension Fund committees should meet jointly with Pension Boards on a regular basis and committee meetings should be held in public wherever possible.

The minutes of meetings should be published.

SBCPF meets all these requirements.

The introduction of Boards and the Scheme Advisory Board has added an extra layer of governance and oversight and the Fund believes a strong proactive Scheme Advisory Board has the potential to ensure all funds are fully meeting the required standards of governance and oversight.

- ***How important is it to maintain a local connection with respect to oversight and strategy?***

The LGPS is a local service. The SBCPF believes that decisions that affect local people are best made locally by elected members and that these decisions should be as transparent and open as possible.

The costs of the LGPS are a significant component of the costs of employing staff and therefore are a significant element of council budgets which local councilors are responsible for.

The SCBPF believes it is important therefore that there is effective oversight and scrutiny of pension funds at local level. This is best achieved where there is close alignment between scheme members and their dependents and those charged with taking decisions. Such close alignment improves accountability. Decisions with regard to investments, ethical investment, environmental issues, risk management etc. should be kept as local as possible so that elected representatives can be held responsible to their members and the local electorate for their decisions with regard to oversight and strategy, and ultimately, their stewardship of the pension fund. The local nature of decision making guarantees an effective voice for employee representatives on pension fund boards.

- ***How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?***

The Propensity to good governance in any organisation bears no relationship to scale. There is no evidence that larger size funds perform better, or that they have fundamentally lower costs. There is no evidence to suggest that the current model is not working effectively either in terms of governance standards or in terms of investment performance.

Operating risks:

- ***How well informed do you feel about the operating risks of your fund? What***

information do you rely on to specify and measure these?

The pension fund in the Borders holds regular meetings with their fund managers to assess and understand the risks associated with their investments.

The pension fund has a published risk policy.

The risk register is reviewed on a quarterly basis by the Pension Fund Committee.

The risk register is publically available here

<https://www.scottishborderscouncilpensionfund.org/media/4253/180614-full-risk-register.pdf>

SBCPF has opted up to professional status under MiFID 2 which requires funds to have access to appropriate, professionally - qualified advice to ensure they can manage risks effectively.

- ***How well are operating risks managed in the current system?***

The performance of the LGPS in Scotland and the content of external audit reports indicate these risks are being managed effectively. The SBCPF has appropriately qualified, experienced officers managing both the pension fund investment and pension fund administration processes. The fund has a strong risk based culture and has effective arrangements in place for managing those risks. The fund does not manage any money internally instead relying on the expertise of professional investment firms. The operation of the fund is supported by independent expert advisor KPMG, external Custodian Northern Trust and our actuary Barnett Waddingham.

- ***How would you improve the measurement and management of operating risks in the current system?***

By requiring members to undertake mandatory training e.g. the Trustee toolkit to ensure they have a good understanding of operating risks.

By requiring each fund to publish a comprehensive risk register for the fund which is subject to regular review.

Infrastructure:

- ***How well informed do you feel about your fund's investments in infrastructure? What information do you rely on?***

The principal of investment in infrastructure is well established where this offers comparative advantage over other asset classes for example diversification benefits or index linked annual income. Scottish Borders Council Pension Fund is actively collaborating in a range of Infrastructure investments with Lothian Pension fund. This arrangement provides SBCPF with cost effective access to investment opportunities which are also being accessed by Falkirk, Fife and NILGOS. Recent investments include renewable energy, telecoms and transport infrastructure.

- ***How do you rate the current system's ability to invest in infrastructure?***

The principal objective of a pension fund is to build up a fund of assets sufficient to meet future pension fund liabilities not to fund public infrastructure projects.

There is an inherent tension between optimizing risk and return for pension funds and delivering public investment in infrastructure at the lowest possible cost to the taxpayer.

There are however excellent examples of the LGPS investing in infrastructure which is increasing featuring as part of the Asset Allocation Strategy of LGPS funds for example it is understood Strathclyde has now allocated over £330m in this asset class.

Scottish Borders has made an allocation of 5% of assets under management to infrastructure and is investing in this asset class in collaboration with Lothian Pension fund

- ***How would you increase investment in infrastructure in the current system?***

The attractiveness of this asset class can only be assessed in comparison to the risk and return profile of other assets. Having an appropriate vehicle to access infrastructure investment in a cost effective manner would assist.

The Scottish Futures trust has recently undertaken work in this area and published a paper with regard to housing infrastructure investment.

The structures to easily enable such large scale investment in infrastructure, which balances suitable returns within an optimized risk profile, with low cost project funding which can match PWLB costs, are not however yet suitably developed. Development of such a model would help to facilitate infrastructure investment.

The desire to see LGPS funds investing in infrastructure is a well-established political objective; however, it must be recognized that fund assets are separate from council funds and they exist to pay for liabilities. Any decision to invest in infrastructure need to be based on an objective assessment of risk and reward to the pension fund as well as the cost and benefit of such investment to local communities. One cannot be assessed and achieved without an understanding of the other and there needs to be an acceptance that meeting the policy objective of having pension funds invest in local infrastructure must result in the risk of lower investment returns or higher pension costs for Local Authorities.

Do you have any additional comments about this option?

This option represents the Status Quo for the LGPS in Scotland and any other options considered must deliver demonstrably better outcomes, based on robust empirical data, for them to be seriously considered.

The LGPS is an integral part of local government and of local decision making and is a considerable success story by any measure. Costs are low, governance is effective, member trust in the current system is high and most importantly funding levels are near

or above 100% in all funds.

The LGPS faces significant challenges, but then so do the rest of the public services, and the reforms being consulted upon within this consultation are unlikely to solve these issues or lead to better outcomes. They could in fact prove highly costly and do significant damage!

Question 2: Promote cooperation in investing and administration between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- ***What impact do you think promoting agreements between funds would have on investment costs?***

Promoting joint agreements relating to collaborative investments could have some positive impacts in terms of fees. This is particularly the case with regard to the cost of investing in alternative asset classes such as infrastructure.

- ***What would be the positive impacts?***

Economies of scale may be delivered to some of the smaller funds through greater purchasing power.

Collaboration and cooperation will give all funds the confidence to invest in a wider range of diversified assets and provide access to a wider breadth of expertise.

- ***What would be the negative impacts?***

Collaboration does not remove the requirement for individual funds to undertake due diligence regarding prospective investments. Each party to the collaborative investment agreement must undertake their own research and fully understand the risks and potential benefits of investing before committing.

Governance:

- ***What impact do you think promoting agreements between funds would have on governance?***

None. Collaboration does not remove the requirement for each fund to ensure its

governance arrangements are operating effectively.

- ***What would be the positive impacts?***

Sharing of best practice and closer cooperation on co investment opportunities should have a positive impact. A wider range of individuals scrutinizing and challenging investment decision should lead to better outcomes

- ***What would be the negative impacts?***

The difficulty of coordinating investment decisions, often to tight market driven timescales could be a potential disadvantage. Collaboration does not remove any governance overhead from individual funds.

Operating risks:

- ***What impact do you think promoting agreements between funds would have on operating risks?***

No material impacts if collaboration is undertaken on a voluntary basis with each fund retaining responsibility for its own investment decisions. Significant voluntary cooperation already exists between LGPS funds that share best practice and access a range of services through nationally agreed procurement frameworks.

- ***What would be the positive impacts?***

There could be potential benefits through economies of scale.

Increase collaboration around Pension Administration could have a positive impact above that already in place. All administering authorities now operate on the same administration system which, whilst working with the provider, could lead to increased synergies around documentation and testing of system upgrades resulting from changes to regulations

What would be the negative impacts?

Formal legally binding agreements need to be documented leading to additional legal costs.

d) Infrastructure:

- ***What impact do you think promoting agreements between funds would have on funds' ability to invest in infrastructure?***

In practice this arrangement is already working effectively with respect to infrastructure.

- ***What would be the positive impacts?***

Smaller funds would have access to a wider range of investment opportunities on a cost effective basis. A recent good example is the benefits that have been gained by Falkirk and Scottish Borders Council through collaboration with Lothian Pension Fund in a range of infrastructure based investments. Co investment provides the opportunity to share legal, technical due diligence costs.

- ***What would be the negative impacts?***

There is however the potential for disagreement and challenge arising from service failure or adverse investment returns. This could increase the risk of legal challenge and require formal dispute resolution procedures.

Risk that under a collaborative investment model inappropriate resilience is placed upon the work of others and the necessary diligence on behalf of individual funds does not take place with sufficient rigor. The effectiveness of any diligence process is reliant upon funds having a clear understanding of the key features and risks associated with investment products.

While not a negative impact, the complicated nature of these investment has required Lothian Pension Fund to set up an FCA registered company which manages the co investment process.

Do you have any additional comments about this option?

Closer collaboration could allow the retention of local expertise in the Finance and HR function providing depth and resilience across Scotland, particularly in smaller authorities, which would otherwise be lost. It should be recognized that expertise in pensions and investment, an understanding of financial markets and pension benefits provides significant advantages and support to the wider local authority. This would be lost under a formal restructuring proposal but could be retained under a collaboration model. This point is linked strongly to concerns over key person risk should restructuring occur allowing the retention of local experience to advise local councillors and board members appropriately.

Question 3: Pool investments between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- ***What impact do you think pooling investments between funds would have on the cost of investing?***

Pooling of investments would require significant restructuring of LGPS investment mandates at significant cost. The study undertaken by Mercers does not support the view that larger fund always have lower costs and perform better based on their snapshot analysis of the LGPS 2015 accounts.

- ***What would be the positive impacts?***

There could be a positive impact on some of the smaller funds fee costs from investment pooling. The larger funds e.g. Strathclyde are unlikely to see much if any benefit due to their existing scale. Reducing costs is important but will only deliver benefit if it improves net investment returns.

- ***What would be the negative impacts?***

The drive to reduce costs may lead to a reduction in the number of fund managers willing and able to engage with the LPGS. One effect of pooling on passive investments in E&W is that fees have been reduced to the level where there are now fewer larger players left in the market. Gains made may however be eroded over time by the as the few remaining firms exert their dominant market position .

Pooling may provide fee costs benefits in the short term but these are also likely to be offset by transition and reorganization costs.

The drive to the bottom in terms of fees may lead to the risk that any short term fee gains made through market competition may not be sustainable in the longer term - which could see reversal of the current position and fees increasing.

The LGPS in Scotland is already able to access comparatively low investment fees when compared to England and Wales as set out in Mercers structure review paper. **If asset pooling were possible, under what circumstances should a fund consider joining an asset pool?**

Pooling should only be undertaken if it provides significant advantages to the fund. These advantages will differ depending on the circumstances of each fund. The performance of the SBPF make it difficult to envisaged what the additional benefits of pooling would be.

- ***Under which circumstances should the SLGPS consider directing funds to pool?***

SBPF is strongly opposed to any proposal that would force pooling on anything other than a voluntary basis. The only circumstances where this should be considered is if there was sustained evidence of governance failures at a local level or evidence that funds were completely unable to meet their long term liabilities on an actuarial basis.

b) Governance:

- ***What impact do you think pooling investments between funds would have on governance?***

Pooling is likely to require additional governance and administrative structures to be established.

- ***What would be the positive impacts?***

There is as yet no evidence that pooling has had a positive impact in England and Wales.

- ***What would be the negative impacts?***

This option may require additional layers of governance, lessen local involvement in investment decisions and make decision making more remote.

c) Operating risks:

- ***What impact do you think pooling investments between funds would have on***

operating risks?

There is likely to be little impact on operating risks arising from pooling. Day to day investment would continue to be carried out by line managers.

- ***What would be the positive impacts?***

SBCPF can not envisage any positive impact on operating risks from pooling.

- ***What would be the negative impacts?***

Pooling will in all likelihood lessen the number of fund managers in the LGPS concentrating investments with fewer firms, reducing diversification and arguably increasing risk.

d) Infrastructure:

- ***What impact do you think pooling investments between funds would have on funds' ability to invest in infrastructure?***

Decisions to invest in infrastructure are only taken where these provide additional benefit to a pension fund for example greater diversification. Pooling is unlikely to have any material impact on a pension funds appetite to invest in infrastructure. Strathclyde, Lothian, Fife, Falkirk and Scottish Borders already invest in infrastructure.

- ***What would be the positive impacts?***

None

- ***What would be the negative impacts?***

None

Do you have any additional comments about this option?

Yes. There are significant risks associated with this option and a lack of tangible data to support it.

Pooling will introduce an added layer of bureaucracy. Staff would be required to run the new pools at potentially significant cost if staffing arrangements and grades sit out with LGPS pay structures.

There is no evidence yet that the pooling arrangements in England and Wales have delivered any cost benefits or improvements in governance. The costs of pooling may be significant and will require substantial professional advice from pension fund managers, investment consultants and actuaries

Tangible evidence is scarce; however, anecdotal evidence of pooling so far seems to indicate that the process has been problematic with concerns over loss of local accountability and governance.

The drive to establish larger pools may perversely have the effect of increasing fee

costs in the longer term as fewer remaining providers are able to exercise their market dominance to increase fees with little risk of losing business.

The timing of the financial transitions required to establish pools may be problematic if disinvestments are executed at a time when markets are volatile. This will introduce risk and unnecessary cost.

Increasing cost may perversely cause pools to invest in higher risk, higher yield assets to recover the ground lost through timing losses and to recover reorg/ transition costs.

Pooling would result in a dilution of local expertise and knowledge potentially increasing risk to the smaller councils where staff often performs a wider role with respect to the financial management of the authority.

Pooling may thereby reduce opportunities for elected members to access financial advice and reduce expertise at a local level.

Pooling will not promote collaboration and expertise across the wider funds' activities.

Pooling of investment will offer no advantages for pension fund administration.

It is concerning that the evidence base used for pooling in England and Wales is so selective, out of date and unrelated to UK LGPS fund performance.

Question 4: Merge the funds into one or more new funds

The text can wrap onto additional pages.

a) Cost of investing:

- ***What impact do you think mergers between funds would have on the cost of investing?***

Merger would require significant restructuring of LGPS investment mandates at significant cost. The study undertaken by Mercers does not support the view that larger fund always have lower costs and perform better based on their snapshot analysis of the LGPS 2015 accounts.

Both investment advisors and investment managers have noted that the effects of pooling in England and Wales are already providing benefits for the Scottish LGPS through lower fees while to date the costs of restructure have been avoided.

- ***What would be the positive impacts?***

Larger funds tend to be able to access cheaper fees due to scale. These may benefit the smaller funds who manage a minority of LGPS assets.

- ***What would be the negative impacts?***

The consultation document notes significant cost savings as a potential advantage of this option. There is however as yet little UK and clearly no Scottish evidence to support this assertion. The larger funds that already enjoy these benefits of scale are unlikely to see any benefits in terms of cost reduction as they already access the cheapest fees.

Proposal is untried and the risks of merger are not fully understood. This feels like a step in the dark for unquantified benefits

- ***If merging were possible, under what circumstances should a fund consider a merger?***

Forced merger could require primary legislation.

- ***Under what circumstances should the SLGPS consider directing funds to merge?***

Significant evidence of governance failures or the inability to meet future liabilities following a deficit recovery period agreed with the fund actuary.

b) Governance:

- ***What impact do you think mergers between funds would have on governance?***

It would have a significant impact on local governance for those councils who currently operate a fund.

A merged model with one governance structure would be cheaper to administer

- ***What would be the negative impacts?***

This would effectively remove a local service from local control. Recent examples of merger in other services at national level have proved to be controversial and problematic with a lack of clarity regarding the realisation of the original objectives.

c) Operating risks:

- ***What impact do you think mergers between funds would have on operating risks?***

It is not clear what effect this option would have on funding levels, which could potentially change for individual employers under a fully merged structure.

- ***What would be the positive impacts?***

This option would eliminate key person risk for smaller pension funds.

- ***What would be the negative impacts?***

This option would however increase pressure on remaining council staff and as TUPE would be required reduce capacity at local level.

d) Infrastructure:

- ***What impact do you think mergers between funds would have on funds' ability to invest in infrastructure?***

It is unclear how merger would assist with the process of investment in infrastructure. If such investment is identified as being the correct course of action for funds as part of their strategy this should be pursued. A number of pension funds are already investing in infrastructure. Collaboration without restructure provides an equally valid route to access infrastructure at potentially much lower cost.

- ***What would be the positive impacts?***

A larger fund may have more appetite for alternative infrastructure investments.

- ***What would be the negative impacts?***

There is a danger that merger is seen as providing a solution to a political aspiration. Potential Investment in infrastructure should not be seen as a driver for this option.

See below

e) Do you have any additional comments about this option?

New governance arrangements would be required and this would incur additional costs during transition.

The move to formal restructure would lessen links to local decision making for example with regard to investment strategy and asset allocation, removing a key role for elected members in the governance of pension funds.

The effect on employer contributions is not known. It should be noted however that some of the smaller funds have the lowest contribution rates at present indicating a high degree of efficiency in terms of cost and investment returns. The funds in rural areas in SBCPF also have the some of the highest longevity for fund members.

The effect of any merger on Fund diversification is not known. There is a risk that investment in assets with higher risk profiles over many years may be required to compensate for the costs of merger.

Full Merger is likely to require expensive restructuring. There is no evidence that restructuring in England and Wales has, or will, deliver tangible benefits when compared to previous arrangements.

Any move to restructure the current LGPS must be based on sound empirical evidence and must deliver tangible improvement for both large and smaller funds when compared to the current structure.

The process of merger may unsettle the membership of the LGSP encouraging transfers out of the fund and discouraging new entrants.

Question 5: Preferred and additional options

The text can wrap onto additional pages.

a) Which option does your organisation prefer? Please explain your preference.

The Fund believes that there is no reliable empirical case for change and much more work would have to be done to evaluate the benefits and risks associated with change before options involving pooling or merger could be supported as being in the best interests of the fund membership.

In the absence of evidence to the contrary the SBCPF is of the view that such change is likely to have a detrimental impact on performance and pensioner confidence and for this reason believes option 1 should be considered. However SBCPF believes increased collaboration (option 2) could achieve a number of positive benefits whilst the options and results of the E&W changes undergo a proper evaluation of the evidence before any change is undertaken. This would avoid the need for pooling or expensive, time consuming and un-proven structural reform.

b) What other options should be considered for the future structure of the LGPS?

There are no other options SBCPF identify should be considered.

c) What would be the advantages and disadvantages of these other option for funds' investment costs, governance, operating risks and ability to invest in infrastructure?

N/A

d) Are there any other comments you would like to make?

No

The consultation questions end.