



Consider all the options

KIERAN QUINN says facts and figures, not opinion and sentiment, are needed for informed analysis on fund mergers



We welcome minister Brandon Lewis' announcement that there will be a call for evidence on the future structure of Local Government Pension Scheme council pension funds, and we support initiatives to improve efficiency and performance of these funds. It is important all stakeholders keep an open mind.

Gathering evidence is the first step. There is a lack of quality data on current costs of running the LGPS, particularly investment management costs where the potential to make significant savings is greatest. Good data will ensure an informed analysis is possible and allow objective decisions to be made. By focusing on facts and figures, rather than opinion and sentiment, we can achieve the twin aims of improving efficiencies and performance while retaining a level of local control.

A lot of the debate centres around the potential benefits from economies of scale. Some research has been carried out in the UK and overseas which suggests that scale benefits could improve net of fees investment performance by 50 basis points or more per annum over the long term (equivalent to nearly £1bn per annum in cash terms). Much of the debate so far has focused on gaining more bargaining power and driving down fees. While this would be very desirable it is not the only advantage. There is further research that suggests further gains of about half this amount could be achieved from a

ADVANTAGES AND DISADVANTAGES OF MERGER

PROS

- Possible benefits of investment scale
- Lower investment manager fees
- More internal specialist resource
- More responsive governance
- May give critical mass for certain types of investment
- More diversification possible
- Larger funds may result in better net of fees performance on average

CONS

- Loss of local accountability and control
- Implementation cost and effort – selecting, resourcing and setting up new or enlarged authorities
- Significant legislative change required
- Better performance not guaranteed – depends on effective implementation, proper resourcing and governance
- Alternative approaches may achieve similar benefits with less disruption and cost?

'governance dividend' such as more responsive governance arrangements, more in-house specialist resource and more diversification by fund manager and asset class.

The extent of any performance improvement achieved will depend on how effectively any structural changes and associated ongoing governance arrangements are implemented. However, if these efficiencies can be realised this would achieve the governments' aims of providing better value for money while the savings could be put towards repairing the deficits of the LGPS funds.

There is more than one way of achieving benefits of scale on council pension fund investments and there are pros and cons in all of the potential approaches.

Fund merger is one potential way of achieving this, and is the route which has grabbed the

headlines and stirred most emotion. But merger would involve loss of local control, would require legislative change and could take considerable time and effort without necessarily delivering benefits beyond those which could be achieved by other approaches.

So can we achieve benefits of investment scale without some of the drawbacks of fund merger? For example, pooling of assets to achieve benefits of scale could be implemented more quickly without regulatory change. This approach would make it possible to realise significant economies of scale with less disruption, while still retaining local decision making on key matters such as asset allocation and deficit recovery plans.

Smaller LGPS funds currently have more limited investment options than large funds and even the largest funds have limitations. Either

option (merging or pooling of assets) would allow funds to be more innovative in their investment strategies.

In addition, either option would allow sufficient diversification to extend the range of assets held, achieving the twin aims of investing for growth and investing for the greater good – green investments, investing to grow the economy, investing in infrastructure and investing in local communities, for example. A series of collectivised investment vehicles available to all LGPS funds could be used for these asset classes to enable more affordable access for all LGPS funds irrespective of size.

Any decision on the preferred approach (mergers to create fewer, larger funds or pooling assets without fund merger) will depend on government policy about localism and practicalities such as any required legislative change, the up-front cost and effort involved and the expected payback.

All stakeholders should be able to agree that it is worth exploring how LGPS council pension funds can work together to achieve scale benefits to improve efficiency and performance.

However, implementing change to improve efficiency and performance is a major undertaking. Time and effort invested up-front in option analysis and planning will be rewarded with better long-term outcomes and a sustainable LGPS for the long term.

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