

Scheme Advisory Board

Meeting of the Board 13th July 2015

BRIEFING NOTE

Summer Budget 2015

Summary

1. On 7th July the Chancellor made two announcements (one via the red book, the other in the speech) that will have an impact on the LGPS.
2. The first, and of more immediate concern, was the announcement of a consultation on legislation for delivering savings via the use of pooled investment vehicles for LGPS fund assets.
3. The second was the publication of a green paper seeking views on the future of pensions taxation.

Use of pooled investment for the LGPS

4. The document which accompanies the budget and is published immediately the Chancellor sits down (the Red Book) contains the detail of the major announcements made in the Chancellor's speech to the House together with those announcements which, for whatever reason, were not included in the speech.
5. The Red Book contains - at page 78 - the following section:

2.19 Local Government Pension Scheme pooled investments – The government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool.

6. Subsequent conversations with officials at HM Treasury have put some context around the statement:
 - Strategic asset allocation decisions will remain at the local fund level.
 - The sector has an opportunity to put forward proposals on the size, shape, number and make-up of the pooled vehicles to be utilised. The SAB therefore has an opportunity to shape the consultation.

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- We also have an opportunity to make a case for exemptions from the default position that the new requirements would apply to all assets of all funds.
 - Treasury and DCLG have not defined or quantified “significantly”.
7. Local section 101 committees will remain responsible for setting the investment and funding strategy and determining the appropriate asset allocation for the fund. Valuations and the setting of employer rates would also remain at the local level. The pooled vehicles would be responsible for the creation of a range of 'buckets' of asset classes for use by the funds, together with the appointment and monitoring of investment managers, custodians and other external service providers.
 8. The sector will have a period to put forward our own proposals for the size, make-up and number of these vehicles. These could include existing initiatives such as the London CIV and could be multi asset or specialised in nature (e.g. infrastructure). Indications are that 4 or 5 vehicles would be in the right ballpark for government. The preference is for the sector to lead on the creation of these vehicles – so we have a real opportunity to shape them in a way that best suits the needs of the LGPS. The alternative is that government will legislate on the creation of CIVs and we will have little or no say in the outcome.
 9. The default position will be for all funds and all assets to be caught by the requirement to invest via pooled vehicle and that the majority if not all listed assets to be invested on a passive basis.
 10. In line with the Board’s previous recommendation to the Secretary of State, an alternative position could be created whereby the mandatory use of pooled investment should apply only to those funds which are deemed to 'failing' and are designated as such by the Secretary of State. This option would fit more closely to the Board's strongly held view that any problem in respect of investment costs lies with a minority of under-performing funds, and that imposing such a regime across the board would significantly reduce the performance of many funds.
 11. This option would require the development of the Board’s position, in particular a clear process to identify those funds to be designated (ie a definition of failing, building on the work currently underway on KPIs); a process for setting out how, and under what circumstances, a failing fund could be mandated; and the likely quantum of savings that could be generated (including savings that would not be incurred through requiring well run, low cost schemes to alter their current arrangements). This may require an acceleration of the current work in order to meet the requirements of this consultation.

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12. If the above option is not acceptable, and the default position remains one of 'all in', then we should take the opportunity to make the case for exemptions. Examples of potential exemptions that could be put forward could include:

- At an asset level: local infrastructure projects (eg social housing) where the management could still be performed more effectively by the local fund.
- At the pooled vehicle level: the inclusion of actively managed portfolios together with rules on which funds can access them and on what basis.
- At the fund level: the situation with regard to internally managed funds needs clarification. A case could be made to exempt them or alternatively form an internally managed pooled vehicle.
- At the fund level: Well performing, cost effective funds that can demonstrate costs (as bps of assets) below a pre-set target over a specified time period could be exempted.

13. As noted above, there is no specific target for savings, but it is expected that these should be 'significant'. However a clear base line and effective baseline measurement mechanism will need to be put in place to measure savings against. Such a baseline and subsequent costing methodology could be either at the gross or net level but in either case consistency and transparency should be prerequisites.

14. A meeting is being arranged with DCLG and HM Treasury officials in the near future to explore the details of the government's intentions and the scope the SAB has for influencing the outcome.

15. The Board's work on pooled investments will take place in parallel with that on deficit reduction. The Board has previously advised Ministers that there are very significant cost savings for and risk reductions to LGPS funds through the more effective management of deficits, and will wish to continue to do so.

Pensions taxation

16. Within a stated objective of encouraging more people to save more the government is seeking views on the future structure of pensions tax relief via a green paper published on 7th July.

17. The document entitled **Strengthening the incentive to save: a consultation on pensions tax relief** sets out the context for potential reform and asks for responses to the following set of wide ranging questions:-

- *To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?*
- *Do respondents believe that a simpler system is likely to result in greater engagement with pension saving? If so, how could the system be simplified to strengthen the incentive for individuals to save into a pension?*

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- *Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?*
- *Would an alternative system allow individuals to plan better for how they use their savings in retirement?*
- *Should the government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?*
- *What administrative barriers exist to reforming the system of pensions tax, particularly in the context of automatic enrolment? How could these best be overcome?*
- *How should employer pension contributions be treated under any reform of pensions tax relief?*
- *How can the government make sure that any reform of pensions tax relief is sustainable for the future?*

18. In his speech the chancellor when referring to the green paper said:

“Pensions could be taxed like ISAs. You pay in from taxed income – and its tax free when you take it out. And in-between it receives a top-up from the government. This idea, and others like it, need careful and public consideration before we take any steps.”

19. Responses to the consultation are due by 30th September.

Board secretariat

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