BERKSHIRE, BUCKINGHAMSHIRE & OXFORDSHIRE PENSION FUNDS: OPTIONS FOR WORKING IN PARTNERSHIP

A. Background

The Treasurers of Windsor & Maidenhead, Oxfordshire and Buckinghamshire the administering authorities for the three funds agreed in 2011 that there should be a review of each authorities' pension administration arrangements to identify areas of common ground and whether alignment of work processes could lead to partnership working which would generate efficiencies and / or cost savings. This was consistent with the messages set out in the report from Lord Hutton's Public Sector Pensions Commission.

The Officers of the three authorities carried out a benchmarking exercise during 2011/2012, concluding that to achieve significant savings would require a major project to identify best practice across the three authorities, which would then enable plans for a much higher level of partnership working and/or integration to be formulated.

Since the initial benchmarking exercise considerable effort has been spent on gaining a better understanding of the working practices of each administering authority and the way in which each authority's pension administration team is structured to deliver services on behalf of the relevant pension funds. Officers have also looked at what sort of structure would work if there was a joint administration function and the likely magnitude of savings that might be delivered by it.

In addition, there has been a lot of discussion in the press about the relative merits of having larger LGPS administering authorities instead of the current position of a large number including a number of smaller administering bodies (on this basis Berkshire, Buckinghamshire and Oxfordshire would each be judged as medium sized – all in second quartile of funds but below average size, but the combination of all three would create a "large" pensions administering body, significantly above average size and in top 10 by Fund size). A lot of attention has been focussed on the London Pension Fund Authority and the London Boroughs in particular. As recently as 24th April at a Public Sector Pensions event, Bob Holloway, the head of the Local Government Pension Scheme in DCLG, when talking about the number of schemes that currently collaborate or share services, said: "I have to be honest though, and suggest that ministers want to see more and they do not rule out the idea of merging funds to achieve further efficiency and improve investment returns." Brandon Lewis MP at the NAPF Local Authority Conference on 21 May 2013 confirmed he was not wedded to maintaining 89 separate LGPS Funds in England & Wales if a smaller number of funds can improve the efficiency and cost effectiveness of the scheme. To this end he launched a call for evidence, prior to a consultation exercise later this year.

It is clear that ministers are discussing and considering mergers of Local Government Pension Funds, and whilst there is no indication yet of what they consider to be the optimum size, there could be an opportunity to influence this for the pension funds in our local area by proposing the merger of the 3 funds. In light of this, an initial analysis has also been carried out on the benefits that might accrue from operating a single LGPS pension fund for Berkshire, Buckinghamshire and Oxfordshire instead of 3 separate funds, and this has been included as one of the options in this paper.

The table below gives a summary of the cost of pension administration and investment for the 3 pension funds for 2011/12:

Table 1: Pension Fund Information as at 31 March 2012

	Berkshire £m	**Oxfordshire £m**	**Buckinghamshire £m**	**Total £m**
Administration Costs	1.071	1.360	1.555	3.986
Investment Costs*	3.201	2.159	2.772	8.132
Total Costs	4.272	3.519	4.327	12.118
Net Assets of the Funds	1,452.859	1,319.994	1,555.512	4,328.365
Costs as % of Fund	0.294%	0.267%	0.278%	0.28%
Membership	51,974	48,489	52,786	153,249
Cost per member	£82.19	£72.57	£81.97	£79.07

* *Investment costs figures only include investment management fees paid directly and do not include fund manager fees for mandates (i.e. pooled funds) where fees are charged internally.*

This paper will examine three options and give an indication of the potential savings that could be realised and then go on to recommend the preferred option and consider the next steps.

B. The Options

There are three main options, which vary in the level of integration and the level of savings. For the purposes of presenting the options, they start with the option which is the most radical but provides the greatest level of potential savings, with the final option being the easiest to implement but with much lower savings. These options are:

1. A single combined Pension Fund with a single administering authority;
2. 3 Separate Pension Funds with a single administration team;
3. Collaborative working expanding on current practice.

Option 1 – A Single Pension Fund with a new Single Administering Authority

The key features of this option are:

- A single 'Thames Valley' Pension Fund;
- Single Administering Authority for the Fund, membership to be nominated by the Pension Fund Board (see below);
- Administration team drawn from the 3 existing administration teams with a longer term goal of creating a single administration team in one location;
- A Pension Board comprising representatives from the main employers/employer groups from across the 3 existing Funds;
- A single Pension Fund Investment Strategy;
- Potentially substantial investment cost savings on fund manager fees, advisory, auditor and other service costs as well as higher net returns;
- Potential administration savings from management and systems costs;
- Total potential benefits expected to be in the region of £2.5m per annum, consisting of c£250k per annum cash savings on administration and in excess of £2m per annum (ultimately) by better net returns than would otherwise have been the case.

Option 2 – Retaining 3 Separate Pension Funds with a Single Administering Team

The key features of this option are:

- 3 separate Pension Funds retained;
- Newly constituted Administering Team through either a new organisation or one of the existing authorities acts as the lead authority for the administration of the fund via a shared service centre arrangement;
- Administration team drawn from the 3 existing administration teams with a longer term goal of creating a single administration team in one location;
- Separate Pension Fund Investment Strategies for each Fund;
- Potential administration savings from systems and management costs, together with investment team savings;
- Total savings could be in the region of £250k with potential for further efficiency savings once the single administration team has been fully established;
- Very little potential for savings on investment management fees

Option 3 – Closer Collaborative Working between the 3 Funds

The key features of this option which is an expansion of what is currently in place are:

- Marginal savings on joint working activities;

- Easy to implement;
- Potential for joint working on matters such as communications, procurement of services;
- Potential for peak work-load sharing;
- Savings from this option would be marginal and accrue individually to each Fund and likely to be non-cashable savings, but enabling the creation of some additional capacity within each of the administration teams.

The risks associated with the options are included at Appendix 1.

C. Recommendation

Given that it provides the largest savings that would accrue to the pension funds, Officers recommend that Option 1 is pursued in greater detail to understand the level of support the DCLG will give to the proposal. The work involved will include building up a detailed business case, understanding the potential costs of implementation and the benefits in more detail. There may be an opportunity to leverage in funding/support from the DCLG (such as the Transformation Challenge Award) if the proposal is adopted by the DCLG as a pilot for LGPS pension fund mergers. In speaking to DCLG, there should also be a clearer opportunity to identify a more detailed timetable for implementation.

Within Option 1 Officers strongly recommend that a new Statutory Administering Authority be created. Whilst in principle it would be possible to transfer responsibility for all three funds to one of the three Councils we believe that strong objections to such a move would be raised by a wide range of stakeholders.

The Public Service Pensions Act 2013 requires each LGPS fund to have a Scheme Manager (the administering authority) and a Pension Board consisting of equal number of employer and employee representatives. A suitable structure for a tri-counties fund could be that the Pension Board is assisted by “Consultative Committees” (one for each County?) and specialist working groups (investment, administration etc). The Pension Board’s role in this case would be Scrutiny and Oversight of the Scheme Manager.

Although Option 2 will provide relatively moderate savings, the potential higher governance costs, investment costs and risks make this option unattractive to pursue, particularly as these savings feature in Option 1 anyway.

D. Next Steps

(a) Creating a Single Pension Fund

The largest potential savings inevitably comes from having a single combined pension fund. These savings would come from the greater purchasing power that would come from having a larger single Pension Fund. This would have the joint benefit of being able to achieve greater diversification than the 3 existing funds, whilst at the same time having larger mandates with fund managers triggering lower fee thresholds or reducing fund manager fees simply by virtue of the size of the mandate. An additional benefit is that with a larger fund it would be possible to justify having a more robust investment team (each of the three funds have key person risk) and the potential for simpler (e.g. gilts) and less liquid funds (e.g. private equity) to be managed internally.

There has been much debate recently in the press and wider about the number of LGPS administering authorities that are needed to administer the LGPS scheme, with views held by ministers that there are simply too many. Whilst there are no clear views yet about the optimum scale for administering authorities, this may be an opportunity to influence and control the future of the 3 existing funds before the government makes its own determination at some point in the future.

If this option is supported by members and is to be explored further, there will be a need to open discussion with the DCLG to understand whether there would be support. The establishment of a new administering authority would require primary legislation through a Statutory Instrument, and there would need to be detailed discussion with DCLG to ensure that the Statutory Instrument enabled the establishment of the new authority and the smooth transfer of the three funds (such as the Statutory transfer of contracts rather than each one having to be renegotiated or novated). Obviously, if the proposal was supported by DCLG, there would then also need to be widespread consultation.

There is recognition that if this option is progressed, there will be long lead in time before a single fund could be operationally efficient and savings maximised. The timeline for the Statutory Instrument would be determined by DCLG, a new Pension Fund Committee would need to be established and a new Investment Strategy established. There would be the initial transfer of the existing mandates from the 3 existing schemes into the new scheme and then a period of transition as opportunities are taken at the appropriate times to move towards the new investment strategy without detriment to the new Pension Fund.

An average 5 basis point increase in net performance (0.05%) achieved across the whole portfolio would equate to a net benefit of over £2.1m. In addition, there could potentially be a reduction in the advisor, custodian, actuarial and performance monitoring fees of approximately £170,000.

(b) Governance

New governance arrangements for Option 1 would need to be agreed and established, including the make up of the new Pension Fund Committee/Pension Board, scrutiny/advisory and consultative group arrangements for key employers and employees in the scheme. Any such arrangements would need to take into account the Public Service Pensions Act and the views of the Pensions Regulator who will be regulating the LGPS from 1 April 2015 (or earlier if the Treasury decides).. This report does not look to provide a governance solution at this stage, but seeks members' views on what should be taken into consideration if Option 1 is supported.

(c) Administration

The move towards a single administration/administering function has been looked at in some detail and a possible structure for a single administration team costed. Once amalgamated as one team, there would initially be savings in the order of £250,000, primarily through the rationalisation of management costs. There may be further savings identified once a single team has been established, but the single administration team would certainly add greater resilience to the administration function.

Again, the delivery of these savings could be over a lengthy transitional period over a number of years, as the 3 administration teams are located in 3 different locations (Aylesbury, Maidenhead and Oxford) and the transfer of staff to a single location too quickly could result in the loss of a significant number of experienced pensions administration staff who are not prepared to travel a greater distance to work. The recruitment of sufficiently experienced staff in any great numbers in a short space of time would be very difficult and pose too great a threat to the operational activity of the administration team. It is therefore considered that the best solution would be to have a transitional period where 3 satellite offices are maintained initially. Through natural wastage it would then be possible to reduce the staffing of the 2 offices furthest away from the final location and replace them at the office which is closest to the final location, until the satellite offices were no longer viable and the administration function formally brought into one location.

(d) Timescales

Each authority is presenting this report to its respective Pension Fund Committees during June and July, with a view to then taking the report on to the Cabinet of each administering authority in July to agree whether they want to pursue any of the options presented.

If there was support for a new single administering body, then the officers of each authority would approach the DCLG to gauge the level of support for the proposal and understand the DCLG timetable for laying the Statutory Instrument. If the proposal was supported in principle by DCLG, a consultation exercise with existing employers and their scheme members would be undertaken, with a view to coming back with a more detailed business case and implementation plan for consideration by the relevant Pension Fund Committees and final decision by the Cabinet for each authority around March 2014.

Although the benefits and efficiencies could potentially take a number of years to fully achieve, this should be seen in the context of the long term viability of the Fund and making sure that any transition risk is minimised.

Appendix 1

RISK ANALYSIS

Risk	Unmitigated Risk			Mitigating Actions	Mitigated Risk		
	Likelihood	**Impact**	**Overall**		**Likelihood**	**Impact**	**Overall**
No buy-in from DCLG *(Options 1 and 2)*	Low	High	Medium	Ministers appear to be keen to explore the opportunity of merging LGPS Pension Funds and may be keen to pilot such an option.	Low	High	Medium
Level of Investment Returns/ savings indicated not achieved *(Options 1 and 2)*	Low	Medium	Medium	The level of savings are relatively modest for Option 1, but the build up of a detailed business case and sensitivity analysis should help to de-risk any savings shortfall, or stop the project in extremis.	Low	Low	Low
Not being able to retain Administration staff to enable to business continuity *(Options 1 and 2)*	High	High	High	Operation of satellite offices to retain existing administration staff and transition to single office over time.	Low	Medium	Low
It takes a long time to generate the savings/ performance improvements. *(Options 1 and 2)*	Medium	Low	Low	A comprehensive project plan with clear and achievable objectives identifying where, how and when savings can be made.	Medium	Low	Low

Risk	Unmitigated Risk			Mitigating Actions	Mitigated Risk		
	Likelihood	Impact	Overall		Likelihood	Impact	Overall
Cost of implementation is greater than anticipated *(Options 1 and 2)*	High	High	High	Early discussion with DCLG should enable the proposal to be treated as a pilot project, which will hopefully attract DCLG funding and resource support. Comprehensive project planning and budgeting.	Low	Low	Low
Enforced alternative merger by DCLG, because the proposed Thames Valley Fund would not be deemed optimum *(Option 1)*	Medium	High	High	Early discussion with DCLG will allow the 3 authorities to influence the shape of any merged LGPS fund and get DCLG buy-in.	Low	Low	Low
Not all administering authorities agree to proceed with the recommended option *(Option 1)*	Low	High	Medium	Early consideration by all 3 administering authorities before undertaking more detailed work and holding discussions with DCLG will ensure that there is collective buy-in before proceeding any further.	Low	Low	Low

Risk	Unmitigated Risk			Mitigating Actions	Mitigated Risk		
	Likelihood	**Impact**	**Overall**		**Likelihood**	**Impact**	**Overall**
Administration Costs could rise due to the complexity of the solution and the governance arrangements *(Option 2)*	Medium	High	High	A process would need to be put in place in order to ensure that as far as possible the 3 separate investment strategies remained aligned in order to optimise the fee reduction benefit to the funds. However there will continue to be an on-going risk of the 3 investment strategies diverging, which could compromise any benefits realised.	Medium	High	High