APPENDIX 2

City & County of Swansea Pension Fund Draft Consultation Response

The City & County of Swansea, has considered the set of proposals which are set out in your consultation document. We are pleased to see that they are broadly in line with the key recommendations within the Society of Welsh Treasurers (SWT) Pensions Group Working Together report 2013.

In order to take the proposals forward CLG have posed 5 questions for consultation, the following is the response of the City & County of Swansea Pension Fund:

Question 1
Do you agree that common investment vehicles (CIVs) would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

In principle yes, however this is largely caveated by the structure and framework of the CIV, it is still unclear as to how the CIV would be implemented (independent body, taken on by an existing Administering Authority, or outsourced to third parties).

In order for Administering Authorities to maintain their asset allocation/investment strategy autonomy, there needs to be sufficient scope and breadth of asset class not only by class but by risk appetite. Noting this, it is even more important that the structure of the CIV is as cost efficient as possible if it is planned to offer a CIV across the investment universe. A more measured approach may be the adoption of CIVs in the more commonly owned and highly liquid asset classes (equities and bonds) than trying to satisfy the varying requirements of the different funds which may have difficulty and (cost) in extricating themselves from existing illiquid investments. A great advantage of the current investment arrangements of the LGPS is the natural risk diversification it offers.

There is a danger that the economies of scale are eroded by a replication of management/administration costs within the CIV. It is recommended that CLG engage with the fund management industry through the IMA and leverage the efficient pooled structures already available by urging fund managers in recognising LGPS as a CIV client and passing these savings onto LGPS through collective negotiations/frameworks entered into with the IM industry. A potential unwanted outcome of this process is a reduction in competition.

Question 2
Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

Yes, each fund has varying funding level/maturity profile/membership and hence its investment strategy should have the flexibility to match those liabilities and demands.

The experience and subject competence in each Authority is variable, however it is envisaged that the revised governance and trustee training regulations will reinforce and ensure robust governance structures are in place to make informed decisions.

An important mechanism that Administering Authorities currently can exercise in the event of non performance by an appointed manager is termination of contract, it is important that each Administering Authority is still afforded this ultimate sanction in the event of a non performing CIV.

Question 3
How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

It should be clear that the objective of cost efficiency is married with the ability of each Administering Authority to deploy its adopted investment strategy.

The number of CIVS should adequately reflect this (and it is envisaged that your proposal of 5 to 10) most fits with this aim. The implementation should start with the liquid most commonly owned asset classes i.e equities and bonds which would allow most funds to deploy their assets into a suitable CIV with relative ease realising the most savings.

The appropriateness of trying to configure the raft of alternative CIVs required would be a considerable task

Question 4
What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

We think it is important that the envisaged cost benefits of the CIVs are not eroded by overly complicated replicated management structures.

It is clear that fund managers have in place legal structures/management agreements which would reflect LGPS as a collective client delivering the associated fee benefits with minimum set up and ongoing costs.

In the above arrangements, the important of robust governance is paramount and the formation of a trustee board made up of investment officers elected members and advisors is recommended to provide the necessary directional framework.

Question 5
In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

The LGPS as whole and CCS as Administering Authority already makes broad use of passive management in the main asset classes (equities and bonds), with CCS investing approximately 34% of its portfolio in this way.

It should be recognised that although passive management offers the most cost benefits from a fee perspective, it is not without its investment disadvantages, (namely market risk, market capitalisation risk, concentration of assets, investment bias, investment inefficiency). In this vein alternative indices should be considered alongside market capitalised indices when specifying passive investing

Of the options outlined, funds should be encouraged to work towards a minimum percentage of funds invested on a passive basis with a comply or explain framework implemented.
This fund has benefitted from the outperformance of active management and the experience of other funds on a localised basis would support the same. There would be increased volatility and concentration of investment risk if wholly invested passively.