

Speech by Local Government Minister Brandon Lewis on the local government pension scheme. Originally given at Cotswold Water Park Four Pillars Hotel. This is a transcript of the speech, exactly as it was delivered.

## **Introduction**

Thank you very much Joanne [Segars, Chief Executive, NAPF] for that kind introduction and for inviting me to open the conference.

You asked me to speak about the new local government pension scheme (LGPS) that we will be introducing next April and I will of course do so. These reforms will reduce the cost of the LGPS to employers and taxpayers. But we also need to think more fundamentally about the way the LGPS is structured. The LGPS has an enviable record on scheme administration and many of you can be proud of what you are achieving. Nevertheless, the scheme has changed little since 1974. Is it still fit for purpose and can it deliver value for money for scheme members, employers and taxpayers?

## **LGPS reform**

Six months ago I spoke at your local authority forum and set out the case for reform and our programme for bringing forward the new LGPS in April 2014. Much has happened since then. In December, we launched the first consultation on the main elements of the new scheme. Almost 150 responses were received which we took on board in a second consultation at the end of March. We received about 30 responses, which suggests to me that we got things pretty much spot on first time around.

The journey from a final salary defined benefit scheme to a new career average scheme, with all the required protections under the Public Service Pensions Act, was never going to be an easy one. There is still a great deal of work to do, including another consultation very shortly on draft administration and governance regulations. But despite the complexities and challenging timetable, we remain on track to deliver the key elements of the new scheme on time.

A great number of you in the audience will have helped to get us where we are today. We are in a good place because of your help and co-operation and I know that I can rely on you all to ensure that the new scheme is a success from the start.

## **Efficiency and cost effectiveness**

Introducing the new scheme is a clear priority for us all, but since becoming Local Government Minister, I have also been clear that looking at other ways of achieving better value for money for taxpayers is equally, if not more important. After all, you are responsible for vast sums of money. You spend about £8 billion a year on pension benefits, while fund management and scheme administration costs alone are almost £500 million a year.

There are plenty of examples where local pension funds are already working together to share services, to establish local or national call-off contracts and in some cases, to pool pension fund assets. This is all good news, but I am equally aware that there are just as many authorities that are sitting on the sidelines waiting to be told what to do.

Many people associated with the LGPS, including a fair few in the audience today, have been to see me with their ideas. Most of them have said that if there are to be fewer funds, theirs should remain because it's the best.

All of them have raised some important points. For example, most agree that we need to see the costs of administering funds and the fees paid to fund managers reduced. To achieve this, we need a better understanding of the factors driving these costs. In particular, I want to understand why the administration and fund management costs of similar fund authorities can vary so markedly.

## **Data**

We need better data to help answer the question about what makes a good, strongly performing fund. It is all too simple to look at funding levels and on that basis, say that fund x is better than fund y. But I think we all know that the position is far more complex than that. Funding levels alone do not determine performance.

We need a more sophisticated model that takes account of other factors such as discount rate, investment returns, cash flow, recovery periods and perhaps, most importantly, the funding strategy statement and statement of investment principles adopted by individual funds. Only then will we be able to compare the performance of individual funds on a level playing field.

A common complaint I hear is that there is no single LGPS annual report. This is something we must address. Pension fund authorities are already required to publish their own pension fund reports and I have no wish to change that arrangement. But academics, trades unions and others tell me they are fed up with having to obtain and then collate 89 different reports to end up with the national picture. I have therefore asked my officials to open discussions with scheme stakeholders to agree the format and content of an annual scheme report to sit alongside individual fund reports.

## **Investments**

The scheme is becoming increasingly mature and it is no secret that some funds are close to becoming cash-negative. We therefore need to see even better and more consistent returns on the £150 billion worth of investments in the scheme.

I therefore want to undertake a root and branch review of the LGPS investment regulations. Some have suggested that the funds should be better directed to support growth, particularly local growth. We have already taken steps to allow fund authorities to increase their exposure to limited liability partnerships, but I accept that we may need to go further.

In particular, I want to know if there are any other obstacles in the regulations that prevent you from maximizing your returns. I am not suggesting that we should dispense altogether with the requirement for you to assess the risks associated with your investments. After all, this is taxpayers' money you are investing and we must continue to get the right balance between risk and reward.

## **Funding deficits**

My other priority is to tackle the equally important issue of fund deficits. We can't bury our heads in the sand and just keep pushing these significant costs on to future generations of employers and taxpayers.

I want to develop a clear strategy that will both address the historical deficits that have built up over past decades and ensure that future funding levels remain at a level which are fair and affordable. I don't underestimate the challenge I have set myself but this is not a problem I can choose to ignore. With your help, I want to find a better way to manage deficits. For example, is there a case for moving away from the concept of long term solvency as a funding target and moving towards a model that looks at cash flows and a fund's capacity to meet pension payments over the short and medium terms?

## **Fund mergers**

I now want to say something about fund mergers. There is probably no other issue on the LGPS radar that attracts such diverse and forthright views. I recognise the tensions out there, and no doubt in the room today, but I am clear that we must explore every option that might give employers and taxpayers a better deal.

Opinion is clearly divided on the issue of whether “big is better”, but for me, the real question is whether “small is worse”. There is compelling evidence from around the world to suggest that the scheme could benefit from a smaller number of optimal funds. But some of you contend that small funds can perform on a par with larger ones. Both sides are equally convinced of their case.

## **Local Government Association/Department for Communities and Local Government roundtable**

All of these issues were raised at a very useful roundtable meeting at the department last week, and I am grateful to the LGA for making that happen.

I was unable to stay for the whole meeting, but I am reliably informed that the discussion was lively and wide-ranging. I expected no less. Among the many different views expressed by trade unionists, academics, politicians and practitioners, a number of common themes emerged.

There was clear agreement that doing nothing was not an option. We can and will put in place a new regulatory framework for April 2014, but this needs to work within a structure that is efficient, cost effective and offers the best value for money. Concerns were raised about the pace of any change and I respect that view. Having the new scheme in place by April next year has to be our number one priority, but at the same time, we cannot afford to just keep talking about structural reform. We need clear objectives and a clear strategy to achieve change.

I was also pleased to learn that a clear consensus had emerged on the need for more focused and better scheme data. Different parties had different ideas about what those needs are, and various attendees said that they would be prepared to lend their experience and expertise in helping to develop a new dataset that better meets today’s needs. I see this as an essential first step in the process to reform the structure of the LGPS.

The point was also made that we need to find a better way of managing pension liabilities to ensure that all future pension payments can be met. It was suggested that a few funds are already cash negative and eating into their assets in order to pay pensions. I think we can all agree that this is not making the best use of fund assets.

It is perhaps no surprise that the issue of fund mergers loomed large in the discussion. The arguments for and against fund mergers were, as ever, well made.

## **The way forward**

So what is the way forward? What is clear to me is that things need to change. We need more transparency, better data, fewer unnecessary overheads and stronger, more consistent investment performance.

What we do not have at this point is agreement on the best way of achieving these goals.

But I am determined that we make progress and make it as quickly as reasonably possible. I can therefore announce this morning, that we will consult later in the year on a number of broad principles for change. This will be your opportunity to tell us what reforms could be made to both help improve your investment performance and reduce your fund management costs.

The consultation will not set out some pre-determined solution to what is undoubtedly a complex and contentious issue. I am neither ruling anything in nor ruling anything out at this stage. However, the clear message from me this morning is that I am not wedded to the existing number of 89 funds in England and Wales. If it takes a smaller number of funds to improve the efficiency and cost-effectiveness of the scheme, I shall not shy away from pursuing that goal.

I have talked a fair amount about the need for robust data to inform decisions. I am therefore working with the LGA and others to launch a call for evidence, which will both inform our consultation and help all involved formulate their views in response to the consultation.

You will be aware that work is well underway to establish a shadow national pensions board for the LGPS. I have met with the LGA and local government trades unions on several occasions to discuss the sort of work that I would like the board to undertake.

I hope I have left them in no doubt that I see work on structural reform of the LGPS, as well as pension liabilities and fund deficits, being one of their first priorities. I have also impressed on them the need for the shadow board to work alongside other representative groups, all of whom must have a say in how we take forward this key element of the reform process.

There is of course the temptation to put all of this to one side and put all our efforts into getting the new scheme in place for April. I appreciate the valuable contribution you are all making to that end, but I believe that I must press forward.

I want good scheme regulations working within a reformed structure that is cost effective and affordable to those who pay the scheme's costs. I am open to the idea that change itself may have to wait until after the new scheme has been introduced, but I am determined to get you thinking now about what changes we need and how they can be achieved.

## **Conclusion**

By the time we meet again next year, the new LGPS scheme will be up and running. On the equally important matter of structural reform, I fully anticipate that we will have a clear way forward to which we are all committed.