LGPS: consultation on collaboration, cost savings and efficiencies

Response by the Environment Agency Pension Fund

Important notice

The document is a response to the Department of Communities and Local Government (DCLG) *consultation and has been approved by the Pension Committee and in consultation with the administering authority Environment Agency. Any questions should be sent to* *dawn.turner@environment-agency.gov.uk*.

LGPS: consultation on collaboration, cost savings and efficiencies
Response by the Environment Agency Pension Fund

FAO: Victoria Edwards

LGPSReform@communities.gsi.gov.uk

Dear Ms Edwards,

In May 2014 the DCLG issued its consultation on the structure of the Local Government Pension Scheme (LGPS) and the opportunities to reduce administration and investment management costs. Please find below the response from the Environment Agency Pension Fund (EAPF) to this consultation that was approved by its Committee on 16 June 2014.

We welcome the opportunity to provide input to the consultation as we recognise it has far reaching implication for the Fund's beneficiaries, its employers, and sponsoring department – Department for Environment, Food and Rural Affairs (Defra). The EAPF responded to the Call for Evidence in 2013, and has been active in supporting the current governance reform agenda, working with the Shadow Advisory Board, the National Frameworks and contributing to the evidence base. We are focused on delivering the best possible outcomes for our members, sponsoring employers and the environment more broadly.

Generally we have welcomed much of the LGPS reform agenda with its focus on improved governance, greater emphasis on training and the willingness to learn from the best private sector experience. In that regard, we note with concern that while the private sector pension's focus is now on "freedom and choice" the focus here appears to be on prescription and regulation.

We would like to emphasise three key risks which contextualises the rest of our submission and responses to the individual questions raised in the consultation.

- The investment approach of the Environment Agency Pension Fund delivers £20-25m per annum through active management (after fees, above its benchmark and with a proportion managed passively) – these are savings realised by our employers and are reflected triennially in the funding strategy and thereby employer contributions. We are concerned with any changes which threaten our ability to provide these returns.

- We already use passive management extensively (30-40%) in our investment approach, to help with diversification and costs, however further compulsory moves to passive would unacceptably increase the risk in our portfolio, increasing financial risks against liabilities and resulting in a sub-optimal investment strategy.

- The Environment Agency Pension Fund has developed a global reputation as a leader in responsible investment. An increased use of passive would curtail our ability to implement our responsible investment strategy and to manage environmental, social and governance risks in the portfolio. These risks include, but are not limited to, exposure to poorly managed companies, the impact of climate change on our assets, and reputation damage from investments in controversial companies.

In relation to the specifics of the consultation we focus on the following 10 key points (references refer to the numbered paragraphs in our detailed response):

1. The Environment Agency Pension Fund is 99% funded and has outperformed its strategic benchmark by1.1% over the last three years.[1] We act as an intelligent client, developing a sophisticated strategy and then leveraging our influence to select some of the best performing external fund managers in the market. We are concerned that the proposals threaten this success, and have an unduly narrow focus on costs rather than net returns, contributions and deficit reduction. The focus of LGPS reform should be on promoting best practice, not on a "one size fits all" approach which forces an unambitious average on those performing well. [2]

2. Our experience is that the key to delivering good performance and value for money is to ensure there is access to appropriate investment skills and expertise within the pension fund in terms of officers, advisors and Pension Committee members. [3] The current reforms of public sector pension governance arrangements should substantially improve standards of oversight and management within LGPS and should be given a chance to work before further change is instigated. A focus on developing capable and proficient investment panels as part of this agenda would be a logical and consistent next step. [25]

3. The current LGPS deficits have little to do with costs, and are instead largely a result of low real yields on index-linked gilts.[8] To help address this, the Government could increase issuance of index-linked gilts (at the expense of conventional gilts), causing real yields to rise. This should lead to a reduction in actual contribution levels near term. In contrast, reducing investment costs (even if we assume there is no impact on gross returns) will not enable contribution reductions for many years.[9]

4. We are concerned that the Hymans Robertson report provides insufficient evidence and is cited selectively for the action being proposed. In particular, the emphasis is on averages and the focus is on a period when governance was deficient. There should be caution in deriving simplistic solutions to complex issues from this analysis.[55]

5. The most effective approach to addressing investment costs would be for LGPS funds to publish an annual statement on costs and value for money in their Report and Accounts, and to disclose their policies on costs and fees in their Statement of Investment Principles (SIP), based on clearly defined cost accounting terms. [49]

6. Active management adds value, if approached on a selective and rigorous basis. The EAPF expects active management to add £20-£25m a year – 1% of the Fund's value. If improved standards across the LGPS could deliver similar results, the value to the LGPS would be £2 billion a year. Returns from active management are particularly useful as they do not increase strategic risk. [56,0]

7. Passive management is not a low risk option against liabilities and indeed is likely to involve increased risks. Standard indices are increasingly recognised as flawed: over-

concentrated, over-exposed to the most overvalued (equities) or indebted issuers (bonds), and "risk inefficient" for long term investors. Leading passive investors are moving away from simple passive approaches and using more sophisticated alternative indexation and "buy and hold" strategies. Furthermore, if a significant portion of the UK's long term asset owners invests passively, systemic risk will be increased, as pricing and selection are left to short term investors and listing authority officials.

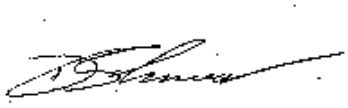
8. We are a leading responsible investor, looking to make investment decisions consistent with the Government's ground breaking Kay Review. The Kay Review already provides the platform for addressing issues of performance, turnover and cost, and is reflected in our strategy. Consequently, we emphasise stewardship, long-termism, and integration of environment, social and governance factors. Limitations on active investment would reduce our ability to deploy capital intelligently, influence the businesses in which we invest and manage our areas of reputational risk.

9. Best practice in asset allocation is more complex and involved than a simple choice between asset classes. It aims to manage strategic risks against liabilities and enhance value. It is important that any regulation supports this flexibility, otherwise the financial implications could significantly outweigh any cost savings[36]

10. Well run Common Investment Vehicles (CIVs) could help reduce costs and improve investment management at some LGPS funds; but they should not be made compulsory, particularly for those already operating to high standards. Careful attention is needed in the design and operation of CIVs if they are to deliver good returns for low risks in a cost-efficient manner, which is best done thorough choice and competition. The EAPF is willing to help the development of high quality CIVs,[31] and would be particularly supportive of one focused on sustainable and responsible investing.[41]

We have provided our detailed response to the questions in the Consultation in the attached document. We welcome the opportunity to work with DCLG in progressing its work to deliver a sustainable and affordable LGPS.

Yours sincerely



Dawn Turner

Head of Pension Fund Management
Environment Agency Pension Fund
dawn.turner@environemnt-agency.gov.uk

2 July 2014

Introduction

1. Established in 1989, the Environment Agency Pension Fund is the only national body to be part of the LGPS. As at 31 March 2014, we have £2.3bn in assets, and our funding level is 99% as assessed by our actuaries Hymans Robertson. Our three year financial performance showed an outperformance of our strategic benchmark by 1.1% per annum, or approximately £25m a year, a vindication of our actions taken to improve financial performance and risk management.

   Our responsible investment strategy continues to evolve and develop, and is an integral part of our investment approach – serving to ensure we, as investors, are considering long term risks and opportunities from issues such as climate change. It also reinforces the support of the scheme's members for the Fund. It was most recently recognised when we were awarded the Portfolio Institutional award for Best Implementation of Responsible Investment, that latest of many awards in this area. In a recent survey of members the pension scheme was voted number one benefit of working for the Environment Agency.

   While we remain far from complacent and are dedicated to continuous improvement, the Fund is well funded, soundly managed, sustainable, and has the strong backing of the employer and members. We therefore find there is little need for radical change or reform as far as our Fund is concerned, although we of course welcome any opportunities to enhance the management of the Fund if they are appropriate for us and help us meet all our objectives.

2. This leads us to our first observation – we are concerned by the one-size fits all approach of the consultation. The proposals seek to impose the average on all funds, rather than focusing on improving the underperforming. This will involve dragging down high performing funds to the level of the average, at significant long term costs to their council tax payers (or in our case, to the environment and flood protection). Given the significant financial implications for high quality funds, restrictions which hamper good performance could result in calls for compensation. To address this and to allow excellence to flourish, as a minimum there should be exemptions for well managed funds from any compulsory measures arising from this consultation.

3. Governance would be strengthened by the clear adoption of the fiduciary duty to act in the best interest of scheme members as recommended by the Law Commission's recent report; the Fiduciary Duties of Investment Intermediaries. Our performance is evidence of the importance of governance in managing LGPS funds. The EAPF has prioritised improvement of governance through development of a highly competent and independent committee supported by a professional team of officers and advisors. We have devoted significant resources to an extensive training agenda for the committee, the strengthening of risk monitoring, accessing independent expert advisors when needed, and particularly the recruitment of a highly experienced and qualified Chief Investment Officer. To improve governance requires enhanced resources and we recognise not all funds have the have

the capacity to take adequate actions: for these Funds some of the options proposed could help improve governance and capacity, such as the proposed CIV being developed by the London Boroughs.

4. We recognise the relevance of costs in managing our pension fund, and we continuously look for opportunities to reduce cost – in the last year cost saving initiatives generated savings of over £330,000 on an annual basis. However, we are concerned that the consultation has an undue focus on costs, which are but one relatively small element of the aspect of running a successful pension fund: most notably, they are dwarfed by potential movements in assets and/or liabilities. Thus, radical action focused on costs, which does not consider the interaction with the other priorities of a pension fund, risks causing more harm than good to the management of LGPS funds overall. Put simply, to avoid unintended consequences a precautionary approach should be taken to reforms narrowly targeting cost reduction.

Our own priority, for example, is to further the understanding of total risk within the fund and to develop a strategy to reduce risk materially across the fund. Judged by market moves over the decade, the impact of this could potentially be measured in the hundreds of millions of pounds. With the benefit of hindsight, if we had hedged real yields in 2008, we could have saved the fund over £500m, far outweigh any saving from reduced fees. So anything which distorts our priorities and our ability to de-risk the fund when opportunities arise could have a serious negative impact on future funding levels and contribution rates, and outweigh any possible cost savings.

5. With investment management, what matters is the net of fees return, rather than the costs, and that should be the focus of attention. Reducing fees will of course increase the net of fees return if nothing else changes, but if changes occur to managers or mandates then the impact may be to reduce net returns significantly. In particular, the evidence of successful larger funds needs to be treated with caution: these funds may have lower costs, but they have not been focused on costs; instead they have taken a balanced view of their priorities and have emphasised sound management. A collaboration focused on costs alone is unlikely to achieve the same success, to read across from these larger funds, the focus must be on a high level of overall fiduciary standards.

6. It must be recognised that even if the "cost" savings are achieved (without undermining returns) they will not result in any reduction in pension contributions in the near term – it would probably be the 2022 valuation cycle at the earliest before the impact on funding level at an individual fund would be material enough for the actuaries to that fund to set a reduction in the contribution rates.[1] Even then, any savings will be so swamped by moves

[1] Based on a cost saving of 0.3% per annum, with a 2016 implementation date, by the 2019 valuation date total savings, and the impact on funding level, would be under 1% and insufficient to trigger a change in contributions

in real yields and assets that they will not be evident. Thus the proposals will deliver no meaningful cost savings in the short to medium term: no council tax will be reduced or front line services saved this decade as a result of these proposals.

7. In the longer term, as we discuss in the detailed submission below, we are very concerned that the proposed changes could reduce our net returns significantly, and could ultimately materially increase our pensions contributions by £20-£25m a year, if we are required to switch to passive investment or use second rate active managers through a sub-optimal CIV structure.

8. We are concerned that there is a fundamental misconception about what has caused the change in funding levels and pressure on contributions. The overwhelming important factor is the impact of interest rates and in particular real yields on the valuation of the fund's liabilities (with increased longevity a secondary factor). Although calculations of funding levels do vary, most rely on effectively using real yields, based on index linked gilts, to discount the value of future liabilities. Thus movements in real yields can have a massive impact on the value of these liabilities. Furthermore real yields are also used to calculate current liability accrual rates. To put this into context, a 0.5% rise in yields would improve funding levels by c.10% and would reduce that part of the employer's contribution covering current pension accrual significantly as well – for the EAPF, the impact is a fall in contributions by around 4 percentage points (from 17% to 13% of payroll). The fall in funding levels and the pressure to increase contributions between the 2010 and 2013 actuarial valuations is essentially due to the fall in real interest rates in that period and nothing to do with a cost induced "death spiral" as some have opined.

9. To address deficits and contributions directly, the Government should consider how to achieve higher real interest rates. One simple option would be to mandate a fixed real yield that reflects a reasonable long term view (as is done with unfunded public sector schemes), but this abandons any market discipline.

   A better option would be if real yields could be increased even moderately. This could be achieved by the Government increasing the supply of index linked gilts [ILGs] (i.e. issuing more ILGs instead of conventional gilts), which would have a direct impact on real yields. Such increased supply would be managed systematically on the basis that the relative value of ILGs to conventional gilts (measured by the break-even inflation rate) should reflect the government's official inflation target. The market level of the 20 year break even inflation rate (RPI), is currently around 3.6%, significantly above the Government's official inflation target of 2% (even allowing for the difference between CPI and RPI), so issuing more Index linked gilts at these levels should be cheaper for the Government long term. This measure would be simple to introduce, ensure policy consistency, be sensible from a macro-economic perspective (as it would send the right signals to the market), and should have a sufficiently dramatic impact that contributions could start to come down from the

2016 valuation cycle (a modest rise in real yields from this move could result in contribution savings of £1bn per annum – in actual cash savings for employers. [2]

10. We are particularly concerned that at no point does the consultation consider the impact of the proposals on responsible investment, long-term investment or corporate governance. This has been area where the government has worked to ensure an improved functioning of the markets, notably establishing the "Kay Review of UK Equity Markets and Long-Term Decision Making". Business Minister Jenny Willott recently said: "Corporate responsibility is a key ingredient of a stronger, sustainable economy." LGPS funds have been at the forefront of the debate about corporate responsibility and governance in the UK.

    The EAPF in particular regards sustainable and responsible investment as a core part of its investment strategy. It serves to manage financial and reputational risks from environmental, social and governance (ESG) factors within our investments. It helps gain the support of scheme members for the fund. It reduces long term investment risk in the fund and offers shorter performance advantages from identifying better managed companies. The EAPF is very concerned that the current proposals could lead to a significant downgrading of this strategy, with long term financial impacts, but also significant damage to our ability to lead and influence on ESG issues as we would be clearly seen to have moved backwards.

11. We are also concerned about the danger of increased systemic risk that the proposals could lead to. Highly centralised CIVs, particularly in unlisted investments, could make mistakes of sufficient magnitude to impact viability of the entire LGPS. Passive investment essentially relies on others to provide the valuation and market feedback to listed companies. Wholesale use of passive investment would remove the market discipline that active management brings and would mean a major category of UK asset owners was abandoning its responsibility to allocate capital efficiently. This would leave UK industry increasingly exposed to short term market forces from speculative investors.

12. We note the impact that this review could have on the UK investment management industry as a whole, particularly if a compulsory move to passive is recommended. The impact on innovation in investment management is of particular concern to us – we have found significant value in supporting small innovative managers and sharing in their long term success. We note the Chancellor has said "The message is simple, the UK is not just open for investment management business, it is actively seeking it. We look forward to working with industry and investors to win it, keep it, and help it grow." We trust a full regulatory impact assessment will be conducted on any more detailed proposals before they are implemented.

[2] Estimate based on a 3 percentage points reduction in contributions. Saving would build up over a few years as many funds have a gradual approach to adjusting contributions.

13. Finally, we make some general observation on success in investment management. Firstly, attention to detail at all levels is crucial. With the current consultation, detail is significantly lacking and our particular concern is that without adequate consideration of the details we will see sub-optimal outcomes and problems in years to come. It also makes responding to this consultation and providing evidence more difficult. The second factor for investment success is to avoid artificial constraints, limitations and restrictions on investment, as these will hamper performance. The focus of much private pension reform is based on the value of freedom of choice, while in contrast these proposals could seriously limit the freedom of funds to make the best choices for them. Finally, those charged with regulation should always be aware of unintended consequences. For example, one very possible outcome is that these proposals could make it significantly more difficult to persuade high quality individuals to get involved with the LGPS as officers or committee members, as investment activity is circumscribed by regulation. This would, of course, undermine the attempts to improve governance.

Q1 Savings from CIVs

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

14. CIVs will only achieve useful economies of scale and real savings to LGPS if they are implemented very carefully, and significant attention to detail is paid in their construction and management. There is a real risk that badly implemented CIVs could end up costing the LGPS significant amounts through reduced net returns. We identify below some of the key issues that need to be addressed if CIVs are to be a success.

15. Because of these concerns, we strongly hold the view that participation in CIVs should be voluntary, particularly for well managed funds. We regard competition and choice in a free market as the best way to achieve high standards, efficient low cost products and positive net returns. CIVs will have sufficient advantages - they will offer funds cost savings and simplified procurement - such that LGPS funds will want to use them. Thus, we consider it very likely that in a few years time that, if the CIVs are well managed and are meeting funds' needs, they will gather the majority of LGPS assets. Failure to succeed is more likely to be indicative of poor implementation than of a fundamental reluctance by LGPS funds that implies a need for compulsion.

Savings and Drawbacks

16. We recognise that in theory savings can be achieved by pooling existing LGPS mandates into larger mandates and that there is probably an excess spread of managers and mandates across the LGPS, with average mandate size below optimal. However, the extent of savings may not always be as expected.

17. There is little point in new CIVs for passive investments. Much passive investment is already done through pooled vehicles. Even if furthered savings are achieved, because base costs are low, the actual savings will be marginal for us and most other LGPS funds. Annual management charges will fall by less than 2bp (or for us a cash saving of less than £100,000). Transactions costs may increase as crossing opportunities will reduce with an LGPS specific pooled fund, as the pool of assets will be smaller than at our current managers. Care should be taken to distinguish the arguments about CIVs from the debate about passive investment: there is no great rationale for advocating CIVs for passive management.

18. However, for active mandates, CIVs may make sense in certain areas and offer decent savings – 20-30% of costs. Savings will vary depending on the mandate – from zero for high quality managers with limited capacity to take on new assets, to significant for some managers able to take on extra funds without increasing costs. We have recently established a CIV with an equity fund manager that offers automatic cost savings of up to

50%. However, caution is needed, the CEM study[3] referenced by the Hymans Roberstson found that the LGPS was already accessing quite competitive rates for asset management, comparable to much larger funds. Savings from merging mandates were not seen as material. (Note the EAPF was a founder participant in this study. Furthermore, there are diminishing economies of scale with merging mandates – savings are greatest when taking individual mandates up to a reasonable size (typically a few hundred million pounds), but diminish for very large mandates (billions) - particularly with the best managers who will worry about client concentration and capacity.

19. More significantly, there are also significant drawbacks to consolidation and the use of CIVs, which could result in lower net returns under a CIV model. The consultation does not consider these drawbacks, yet addressing them is key to successful CIVs.

- Many high quality specialist managers may not want to participate in a large scale CIV, for reasons of capacity and client concentration. For the EAPF, the focus is increasingly on high quality specialist managers with strong control of capacity (to avoid becoming too large) as we find these managers best at adding long term value. For example, we would almost certainly lose access to our best two managers, who have added substantial value in the last few years. CIVs that end up focusing on large, “asset gathering” managers with limited added value would not be desirable.

- The centralised approach that CIVs will represent will make it difficult to refine or modify mandates to address performance issues or enhance risk. For example, we reviewed and refined a mandate that had been performing poorly, identified key issues, both with the benchmark and an element of manager’s style, and proposed a change in benchmark to address these issues. Over the nine quarters since the change, performance has been 21.2% above the conventional benchmark, with a value added of £26.1m. With a CIV structure, getting agreement and consensus for such a change would be more protracted or even impossible – given that standard “naive” benchmarks are very much the norm.

- CIVs inevitably involve a loss of individual reporting and reduced manager access. This would undermine our own commitments to reporting and accountability, but more significantly would also make it harder to evaluate managers and understand whether they were still appropriate for our needs. Thus CIVs could increase risks to the fund of financial loss from failing to detect early warning signs at deteriorating managers.

- Of particular importance to the EAPF is that the managers we employ take their stewardship and governance responsibilities seriously, actively consider environmental, social and governance factors in investment decision-making, and engage with us on these issues (for example, through participating in environmental

[3] Appendix 1a Investment cost benchmarking CEM Inc., LGPS Structure Analysis - December 2013.

foot-printing analysis and regular dialogue with us on engagement activities). These elements are fundamentally important to us, not just because we believe they can enhance performance, but for ensuring long term risks are managed and for protecting the environment and our reputation. With a CIV we will probably not be able to make these requests of managers and will rely on a third party to hold managers to account, with the likelihood that standards will fall.

Implementing CIVs

20. Implementing CIVs well involves ensuring they are well managed, well governed, adequately resourced, flexible enough to meet both investors varying needs and different market environments. These issues are similar to the governance needs faced by funds in the LGPS. We note the current governance reform agenda in LGPS is still very much work in progress, and there is risk that an extra organisational layer, requiring its own high degree of governance focus, is being introduced before reforms to improve governance more widely have had a chance to work through. Any estimate of the potential savings needs to take account of the implementation risks and likelihood that not all savings will be realised as proposed.

21. We would recommend and welcome flexible, open CIV structures, where it is possible to create asset classes for particular managers' products relatively easily, and where individual LGPS funds can choose the most appropriate funds for them. These would essentially be similar to a fund supermarket or platform and would be a sensible way forward. It would enable consolidation of existing mandates and encourage rationalisation of manage numbers medium term, achieving savings rapidly without significant drawbacks. We understand this is the model being pursued by the London Boroughs. We are strongly supportive of the principles that the London Boroughs have established to support the development of this model of CIV, to be used elsewhere by the LGPS. This process of consolidation and rationalisation is likely to happen reasonably speedily and naturally once appropriate vehicles are set up: the advantages of easier procurement, reduced costs and enhanced visibility will enable change, without further action.

22. However, we are more cautious about more centralised approaches to CIVs, for example, where the sub-funds cover generic asset classes and manager selection is done within the CIV - "manager CIVs". While in theory these will offer greater savings from increased consolidation, these savings are likely to be marginal, the issues of governance and management far more significant, the CIV will have to address issues of liability, and many of the drawbacks indentified above become more significant (e.g. limited access to the best managers, issues of accountability and transparency etc.)

23. Other options for pooling assets appear to have been rejected without having been given a chance to work, such as fund manager led pooled funds and framework procurement arrangements for fund managers. We have worked with a boutique fund manager to create a CIV which is tailored to the needs of LGPS funds and which offers automatic fee

savings, particularly to smaller funds, through pooling investment with this manager. For smaller investors in particular, this vehicle offers cost savings of 40-50%, We had also been developing a framework agreement for a sustainable equity mandate, which would facilitate multi-user access to a selection of the best sustainable equity managers in a efficient way, with potential for costs savings from shared mandates. However, in light of the current proposals we have decided not to pursue this framework further. There is still a case for letting these other initiatives and approaches develop further, rather than focusing solely on the CIV model.

24. We have successfully partnered other South West funds in setting up frameworks for legal, benefits and investment advice which have already saved £1.5m[4]. We are currently working, as part of the National Frameworks team, to extend the legal framework nationally. The local and national frameworks have delivered considerable savings in their short lifetime and look to be gaining momentum. We recommend that the benefits and cost savings from the frameworks is more fully reflected in any recommendations for change.

25. An alternative approach, reflecting that the real objective should be to enhance net returns in the LGPS, would be to focus further on the skills and knowledge required to manage investments well, and require LGPS funds to delegate most investment decision making to a panel or subcommittee with a high level of investment knowledge. Importantly, it should be possible to share such panels between funds, saving resources and sharing expertise. As these panels became established they might well seek to establish CIVs as the easiest ways to do their business.

CIVs for unlisted investments

26. CIVs for unlisted investment are an interesting concept, and the theoretical cost efficiency is appealing, but we regard the practical issues as significant and particularly challenging, because of the illiquid, long term nature of these investments. If poor investment decisions are taken they could be very expensive and difficult to rectify. In addition, there are different issues with different asset classes (e.g. property, infrastructure, private equity, hedge funds) with different approaches required in each area.

27. For the EAPF, fundamental to our investment in unlisted investments is our need to ensure that environmental risk (especially climate change risk) is adequately factored into investment considerations, because of the long term, illiquid nature of these investments. This is particularly relevant in infrastructure and forestry, which also carry significant reputation risks for us. Ensuring these issues are adequately addressed has been a priority for us, and we would need to see a robust process on these issues in any CIV before we considered investment in it.

[4] South West Framework response to the Call for Evidence, 30/09/13.

28. Although the fund of funds model comes in for much criticism on the grounds of cost, there is inadequate recognition of the advantages of such an approach, in particular diversification, so that assets are not tied up in one particular investment. When we considered our recent mandate for real assets, we recognised the value of the importance of diversification but rather than a fund of funds decided to use a "delegated management" model, where the selected manager builds up a portfolio of funds on our behalf. This was able to be tailored more to our needs, and the fees were less than a third of the 1% typically charged by funds of funds. In addition, our manager is actively negotiating fee discounts on our behalf, either because of the bulk investments they are able to make (they have total assets under management or advisement of over £50bn) or because we are a lead investor. A CIV could adopt a similar model but we would need convincing that it could deliver overall costs savings in excess of those we are achieving at present – cost savings at the CIV level must not be undermined by higher costs at the underlying fund level. A CIV would also need to reflect our needs to an acceptable level, which might be challenging given its pooled nature, and the priorities of other investors.

29. We note that many LGPS funds already invest directly in alternative asset funds, although with some hesitation given the expertise involved. However, this suggests that there may be scope to establish a collaborative due diligence and advisory service, pooling expertise and knowledge across the LGPS. This would enable the sharing of costs and more effective collective negotiation with alternative asset managers. It would support individual decision making and direct investment by LGPS funds. This would potentially be lower cost and simpler than a CIV (which is arguably an unnecessary layer), but also more flexible. It could also be introduced on a much quicker timeframe than with formal CIV structure.

30. An alternative approach for an unlisted asset CIV would be one that invested directly in the assets. Although the most cost efficient approach, it is also the highest risk because diversification is limited, and has the greatest requirements for expert management. We are interested but very cautious about such an approach. For example, when considering such an approach in the area of infrastructure investment there are a worrying number of aspects in current proposals:

    - a degree of haste and artificial timetables, rather than a considered approach;
    - possible compulsion rather than competition and choice;
    - signs of excessive investor demand already in the area;
    - the significant challenge of recruiting infrastructure specialists; and
    - possible inappropriate government influence.

    We note that far from a focus on large scale infrastructure, we are finding the best opportunities at the moment are smaller niche opportunities that are ignored by many large investors: there is a real risk that when a LGPS infrastructure CIV is launched it may

be the wrong approach at the wrong time. Thus we have invested, alongside the Green Investment Bank, in a niche energy efficiency fund, an opportunity which offers good returns while helping UK businesses, but which has been ignored by larger investors.

31. To summarise, we would be supportive of high quality CIVs for unlisted assets, but this means competent governance, a strong management team, appropriate strategy, and for us, strong environmental risk management. If not satisfied and not allowed other options, we would rather not invest in a particular asset class than invest in an unsatisfactory vehicle for the long term, although this would be sub-optimal from an investment strategy perspective. We are particularly concerned that our commitment to invest in infrastructure could be jeopardised by these changes. **Because of these factors we consider a voluntary approach to be essential.**

Q2. Asset Allocation

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

32. Yes. It is essential that asset allocation is kept with administering authorities. For comparison, compared with the typical LGPS fund the EAPF is less mature (i.e. has longer duration liabilities), is better funded (current estimate 99%), and is more cash flow positive. These differences are all relevant when considering asset allocation.

33. However, we are concerned that the consultation has a simplistic view of asset allocation, simply regarding it as the balance of the two or three different asset classes. Our approach to asset allocation is considerably more sophisticated and rigorous. It reflects the best practice of larger pension funds, and of evolving financial understanding. Among the areas that are relevant to a well considered approach to asset allocation are:

    a. Understanding liabilities, funding levels and contributions financially and how to manage them – including hedging liability exposure through gilts and related derivatives.

    b. Structuring within asset allocations to enhance return and or to reduce risk. Thus for equities we have looked at improving the risk return characteristics of our equity allocation by increasing allocations to particularly style factors – low volatility, value and quality, as this will reduce risk against our liabilities.

    c. Taking a risk factor based approach to asset allocation: identifying sources of risk and return, and ensuring there is an even balance between them. On a risk based approach to asset allocation, the details of how an allocation is implemented can be as important as the asset allocation itself.

    d. Looking at potential overlay strategies, primarily to reduce risk, including option based strategies, “tail risk” strategies, dynamic overlays and other hedging approaches.

    e. Considering long term climate change and other environmental, social and governance risk factors in asset allocation, and how to mitigation them effectively.

34. The oft-cited view that asset allocation accounts for the vast proportion of returns is dangerously simplistic. While retrospectively it is true that picking the right markets will make a huge difference in returns, prospectively this is difficult to do well in the short to medium term. While increasing allocations to risk assets may increase expected returns it will also increase risk levels significantly. In this context, anything that investors can do to fine-tune asset allocation or exploit other sources of return, such as active management, without materially affecting risk is particularly valuable.

35. We also observe that the role of the strategic benchmark is over-emphasised in the report. The strategic benchmark is a useful tool, particularly in the short to medium term for monitoring performance. However, it involves significant risks when compared with liabilities and over the medium to long term a direct focus on liabilities is more relevant. As a result, some funds use liability based benchmarks, and others are considering multiple benchmarks. Furthermore, as we increase our focus on total risks across the portfolio, further limitations of the strategic benchmark becomes apparent as risks cannot be disaggregated in the same way as returns.

36. Thus, in order to manage our fund optimally and in the best interests of employers and members, we need to be able to take a sophisticated approach to asset allocation, which means we need access to a wide range of different investments. This is discussed more in the next section, but would include notably sustainable equities, low volatility equities and sustainable real assets. It is also important that there is real choice, with high quality options in each area: as already discussed we will not invest in a particular asset area if the implementation is unacceptable, although this would mean a sub-optimal asset allocation.

Q3. How many CIVs

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?

37. In many respects the number of sub-funds/asset classes is more relevant than the number of high level CIVs. As discussed previously we regard choice and competition as very important in ensuring we can access the best possible options for the fund – it keeps the market strong and safeguards against complacency. So in many areas to have several different choices would be appropriate. Combined with the need to be able to reflect detailed asset allocation means that there should be access to a large number of sub-funds/asset classes.

38. We are exploring with other LGPS funds in the South West the potential for creating a regional CIV to better co-ordinate mandate selection and achieve economies of scale, including the extent of potential synergies and the various costs involved. We believe there are merits in regionally based CIVs.

39. If a “supermarket” type CIV is pursued, with relatively open access to LGPS funds or managers seeking to set up sub-funds, then it could have a large number of sub funds and the need for multiple CIVs is less clear, although there are merits in having a spread of custodians and other service providers for enhanced resilience.

40. If the CIV is more actively involved in selecting managers and managing an asset class, then there is a strong need for several different CIVs to provide competition and choice for individual LGPS funds. Competition helps to keep the market strong and avoids complacency in the medium term. Choice will also help defray potential issues of liabilities that could arise with such CIVs. Different CIVs could develop different strategies, approaches and areas of expertise. To permit reasonable choice, and allowing for the fact that not all CIVs will have expertise in all asset areas, we feel the number of CIVs should be close to or even above the higher number suggested in the proposals (10). The negligible cost advantages of greater concentration are not worth the drawbacks of reduced choice and competition.

41. In particular, the EAPF would very much want to see a CIV established which focuses on sustainable and responsible investing, and seeks to take leadership in this area – without it we feel that the EAPF’s industry leading responsible investment strategy could be compromised. The EAPF would be willing to take the lead in developing such a CIV. If CIVs are made compulsory (which we not advocating) such a CIV would become essential for the EAPF.

42. As discussed under Q2, a wide range of asset classes/sub funds should be available (with competition and choice for most asset classes) with the following being needed by the EAPF to implement its existing strategy, and without which the investment management of the fund would be degraded. Furthermore the range of options and areas is continually developing and evolving, particularly as we refine our responsible strategy, e.g. in areas such as green bonds, climate solution funds and carbon constrained indexes.

Equity sub-funds	**Bond and Alternative sub-funds**

• Sustainable global equities
• Environmental global equities
• Low volatility global equities*
• Value orientated global equities*
• Sustainable emerging market equities
• Bespoke UK equities*
• Private equity*
• Sustainable Private Equity
	• Index linked bonds (for liability management (LDI) needs this should be done on a fund specific basis.)
	• UK corporate bonds*
	• Hedged global bonds*
	• Private debt/bank loans*
	• Sustainable real assets (or:
	  • Property*
	  • Sustainable Property
	  • Sustainable infrastructure
	  • Sustainable forestry
	  • Sustainable land/agriculture)

All asset classes without an explicit focus on sustainability/environment (indicated *) should incorporate robust responsible investment policies.

Q4 Types and governance of CIVs

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

43. We consider the type of vehicle is less important than many of the other issues with developing a CIV as discussed above: competence, governance, flexibility etc. all of which need to be adequately addressed first. In particular, we note the cost of setting up a CIV is not insignificant, and ensuring CIVs have adequate initial resources is important. If convinced of the advantages of a CIV, DCLG should be prepared to support funding their initial creation and resourcing.

44. That said we note that the new Authorised Contractual Scheme established recently in the UK looks to be a suitable and flexible vehicle for use by the LGPS. It particular we note its flexibility and the ability to create a wide range of sub-funds makes it a potential vehicle for a high quality CIV. However, it is also relatively new and unproven, which could result in increased costs and delays in establishing suitable vehicles.

45. The governance and management of any CIV is of key importance. It would be particularly significant if the CIV is to make extensive investment decisions e.g. selecting managers and allocating between mandates. The governance of a CIV should be driven by its investors, through a board. Individual sub funds should have their own governance, so it should not be possible for investors uninvolved in a sub-fund to control that sub-fund.

46. The need for CIVs to integrate responsible investment, long term investing and high standards of corporate governance and transparency at the design stage is essential. If the CIV option is pursued, we would like to see a mandatory minimum requirement that any CIV for LGPS funds should include the requirements of the UK Stewardship Code and the implementation of the UK Corporate Governance Code, or similar international standards for overseas stocks.

47. The governance and management of the CIVs becomes particularly important if there is compulsion to use CIVs which are making active investment decisions. Although enhanced governance can help mitigate risks, we consider competition and choice to be far more effective at ensuring that the CIVs are well managed, so this approach should be avoided.

Q5 Passive Management

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 [below] offers best value for taxpayers, Scheme members and employers?

- *Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.*
- *Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.*
- *Fund authorities could be required to manage listed assets passively on a "comply or explain" basis.*
- *Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report*

48. In response to this question please also refer to our covering letter containing 10 key points and the introduction to this response, as well as the points below.

49. We believe the best option for taxpayers, scheme members, and employers would be a strengthened version of the last option: Funds should have a policy statement on fees and costs, including the use of active management (probably as part of the SIP) and should have an annual statement on value for money (not just costs) in their report and accounts. This would be sufficient to ensure all funds were paying appropriate attention to their investment management fees and the value obtained from them. Suitably specified it should also ensure greater comparability.

50. A comply and explain option would be our second preference, however we consider that it has the wrong emphasis if it focused on passive investment alone: passive investment is a possible means to an end (lower costs) rather than the objective itself. Policy and disclosures focusing on overall costs, net return and value for money are more appropriate.

51. Any compulsory use of passive investment management would have significant negative effects on the Environment Agency and other employers. In particular, a complete requirement to implement passive would result in the lost of significant value to the EAPF, of £20-25m a year, which eventually will be reflected in reduced money for flood defence and environmental outcomes through increased contributions. It would increase investment risks to the Fund as it would reduce options to manage risks. It would also seriously damage our responsible investment strategy, which would increase long term risks to the fund, increase reputational risk to the Environment Agency as administering authority, and undermine member confidence in the fund.

52. The reasons behind this recommendation are that

    a. use of appropriate active investment management can add value;
    b. active management offers other material advantages in terms of risk and long term ESG integration;
    c. passive investment is flawed, with many benchmarks deficient and sub-optimal;
    d. defining passive management in practice is problematic.

53. We believe our approach to costs and the questions of active and passive management is a more appropriate approach that any formal requirement to use passive investment. Our high level investment principles (SIP) cover costs and value for money, and are contained in our Annual Report and Financial Statements 2013-14, available on our website, but essentially when considering a new mandate we start by considering whether we can do it with passive investment, and what if any issues might arise with a passive approach. We then consider an active approach for the same mandate, focusing on the cost differentials, the scope for an active manager to add value, the impact on risk, and ESG integration. Only if convinced that active investment offers a better option will we pursue it.

To demonstrate this intelligent selection process in action, in 2012 we reviewed our equity strategy and decided we wished to make allocations to both “value” equities and “low volatility” equities, in order to improve the risk-return profile of the portfolio. When we looked at implementation, both mandates could be implemented passively using specialised indices or actively. After consideration of the cost implications and value of active management we decided to implement the low volatility allocation through active management, as an active approach could avoid overpaying for popular (and possibly overpriced) low volatility stocks while a passive mandate would not be able to apply this control. In contrast, with value investment we did not find adequate case for active management, so have implemented this passively. Since we have invested, we have found that our low volatility managers have significantly outperformed the low volatility benchmark, while it is not clear that an active value manager would have added significant surplus returns on that mandate.

54. We are very concerned that the Hymans report provides insufficient evidence for the more radical actions being considered here, as analysed below. There should be caution in deriving simplistic solutions to complex issues from this analysis. We would also make the following observations.

    a. The argument that active investment must be a zero sum gain is simplistic and fallacious: there are sufficient other (non-benchmarked or non profit-maximising) investors (individuals, companies with strategic investments, traders, absolute return funds etc) as well as investment options (cash, non benchmark holdings etc) that in theory mean it is perfectly possible for active managers to add value generally.

b. We note that actuaries do not penalise active management when making their assumptions of asset outperformance – despite taking a prudent approach and erring on the side of caution in their forecasting.

c. Most of the large funds we are familiar with make significant use of active management: the best resourced investors in the world do not accept these arguments in favour of passive and are prepared to invest actively – although of course they do so in a targeted and sophisticated way. We understand that two of the UK largest pension funds, BTPS and USS, are reducing their exposures to a simple passive management approach.

Active management can work

55. We regard the evidence provided in the consultation of the value of active management and performance as significantly flawed.

a. The consultation looks at averages, not at best practice and the value that can be added by a well considered use of active management.
b. The DCLG has already identified governance as deficient in the LGPS and is taking actions to rectify this. Without further analysis, the data provided merely provides evidence of this weak governance and it would therefore be inappropriate to take further action until measures to improve governance have had a chance to have an impact.
c. The Kay Review of UK Equity Markets and Long-Term Decision Making has already identified issues with investment management in the UK, in that it is too focused on the short term, there are perverse incentives in place, that costs and turnover can be too high. Rather than reject active management outright, it has proposed a number of remedies and actions to reduce costs and improve long term performance. These have been positively received by the UK government and by industry, and are currently being implemented. Thus from the perspective of the investment management industry, the analysis is also historic and not representative of the current state of the industry.
d. Many of the asset categories cited are where it is generally acknowledged that active management finds it more difficult to add value (e.g. North America large companies). In contrast, active management has been more successful in areas such as emerging markets, corporate bonds, small caps and specialist mandates. Even a global approach to equity investment (as adopted by the EAPF) rather than the regional approach cited is more likely to enable successful active management, so the use of regional mandates is biasing the data.
e. There are a number of technical issues with the data. The ten year period, although fairly long includes a period of exceptional turbulence which challenged many active managers. They had a much better experience in the late 1990s/ early 2000s, and in 2013. Our own experience of high level performance analysis is that it can be misleading – when we analysed our performance in detail we found it was not

manager results, but inadvertent asset allocation decisions that was hampering performance. We suspect this may be a significant factor with other LGPS funds, and the real reason behind the performance findings, but to establish it requires more detailed analysis.

56. We, based on our own experience and independent research, are strongly of the view that appropriately selected active managers can add value. However, this does not apply everywhere or to any mandate. Success is significantly more likely if the mandate is in an area where there is increased evidence that active managers can do well (typically markets where information is less widely available and there are fewer brokers, such as emerging market equities, corporate bonds, and small companies); or where the manager has a clear focus on a successful model (e.g. focused high conviction, long term manager). We are indeed cautious about investing with “traditional” active managers where they may be a degree of “closet indexation” and no clear evidence of any particular advantage. As a result of this focus, our listed asset managers have added significant value overall - over £50m over the last two years (or more than 2%) – this is despite having a significant allocation to passive. To illustrate this, the performance of two managers we have particular conviction is shown below.

		Outperformance % p.a.				
Manager	Asset Class	Target	1 year	3 year	5 year	Inception (date)
Generation Investment Management	Global equities	+3	6.6	4.2	4.1	7.0 (2008)
Royal London Asset Management	UK bonds	+1	2.9	2.4	4.3	1.2 (2008)

57. Our investment consultants, Mercer, have extensively evaluated the ability of properly resourced manager selection to add value. The table below shows the average outperformance by their "A" rated managers across various investment universes. It provides good evidence that well chosen managers do outperform.

Average outperformance of recommended managers (% p.a.)

	3 year	5 year	Inception
All Equity categories	2.3	1.6	2.0
All Fixed Income categories	0.9	1.9	0.8
All Other categories	0.6	0.8	0.6
All UK categories	2.3	2.1	1.4
All Categories	**1.6**	**1.6**	**1.4**

Source: Mercer. Reproduced with permission. Date is to 31st March 2014. Figures are gross of fees. For information on methodology, inception dates etc please contact Mercer.

58. This analysis implies that any under performance is a weakness in manager selection at some LGPS funds rather than a fundamental problem with using active investment. Better governance would help address this (discussed in paragraph 25), as would a flexible and open approach to CIVs, which avoids the delays and bureaucracy of EU procurement. These options are preferable to an arbitrary approach enforcing passive management which penalises well managed funds.

59. In contrast to notional cost savings from switching to passive the aim should be to boost the net returns from the LGPS from rigorous manager selection. If our experience was repeated, it should be possible to boost returns across the LGPS by as much as £2bn a year, which over a five to ten year period would help to materially address deficits in the LGPS. The key to unlocking this, as discussed, is improved governance and professionalism.

Managing risk and accountability

60. It is important to recognise that passive investment is not a low risk option for LGPS funds. Passive options are low risk against their benchmarks, but are not low risk against a pension fund's liabilities or in terms of funding level. The risk of an active mandate against liabilities is often similar to passive management, but with certain managers and active approaches, risk can be significantly lower against liabilities - which is what matters for

pension fund. It can also be analysed and managed directly in a timely way. Both the managers cited above have strong approach to risk that is superior to their benchmark indices. Generation have an absolute return mentality and did particularly well in 2008. RLAM have a very diverse portfolio, with a better spread of investments than the benchmark, and a very steady performance record.

61. We have spent considerable time with our managers making sure they consider and integrate risk factors into the portfolio, particularly in areas such as climate change risk and environmental performance. With active managers we can discuss any excess risk with them and ensure their approach is acceptable. With passive managers we have limited options and may have to accept higher risk levels than we would like to. For example, in our recent review of our potential exposure to "stranded assets" that could be at financial risk from climate change, our most significant exposures were found in our passive mandates. Managing these risks is difficult: it can be done passively with specialist benchmarks, but even then the approach to risk is likely to be less sophisticated than at our active managers.

62. Building on this, it should be noted that there are real governance issues with passive investment – investment decision making still occurs but is being handed over to a combination of bureaucrats, stock market regulators and index providers – none of whom we have control over or direct links to. Furthermore, their decisions are not motivated by long term investments, but by factors such as a desire to promote an particular stock exchange. This has resulted in governance standards being ignored, or companies with significant non-financial risks (e.g. involvement in persecution of minorities and human rights abuses) being listed and included in portfolios.

Passive investment has significant limitations

63. We, leading industry practitioners, and many expert researchers have considerable concerns over many of the standard benchmarks and methodology of index construction, with implication for passive investment. This is a fertile area for in**ve**stment research – while the arguments in favour of passive investment are not new, increasingly over the last decade researchers have focused on the drawbacks of passive investment as well. For example:

- Market Capitalisation equity benchmarks have the highest exposure to the most overvalued companies - this effect meant passive investors were very highly exposed to the overvalued technology sector at the start of the 2000-2 bear market, and suffered accordingly – while most active managers lost a lot less.
- Many common benchmarks have significant flaws. So both the main UK and Emerging Markets equity benchmarks are over concentrated in a few large stocks and exposed to the "wrong" sectors (notably resources – the UK isn't a resource based economy, and investors wanting passive exposure to the long term growth

story in emerging markets may be disappointed to find excessive exposure to historic, low growth mining stocks).

- There is growing evidence that market capitalisation-based passive investment isn't risk efficient – with alternative approaches offering either higher returns or lower risk or both. The concentration of many benchmark indices, together with the sector and country bias, and the fact that valuation bubbles increase concentration, indicates the scope to reduce risk.
- Bond benchmarks are particularly inefficient and suboptimal and have the greatest exposure to the most indebted borrowers – so the more a company borrows (and its credit quality deteriorates), the more passive investors hold of it.

To provide a real illustration of the inefficiencies of passive benchmark, a small tweak to our UK benchmark (to cap holdings at a 2% weight to address the concentration issue) has boosted performance by 3% a year. With passive benchmarks so dependent on the underlying methodology, regulators should be cautious over their use.

64. Understanding the issues around passive investment has led to interesting new approach, both "smart beta" (sophisticated alternative indexation) passive approaches and new approaches to active management. Not surprisingly where the benchmarks tend to be less perfect there tends to be more scope for active management to add value. As discussed, the performance data in the consultation document focuses on precisely those markets where adding value may be harder, rather than say corporate debt and emerging markets.

65. Passive investment, particularly through pooled funds, has a number of practical issues. It involves loss of control over stock lending, as well as over corporate governance and voting. Turnover, particularly over index changes is not as low as often perceived, and passive managers will actively trade to ensure they perform in line with index after costs.

Passive Investment is impractical

66. There are significant practical issues to consider if seeking implementing a focus on passive in a consistent and logical way. For example:

a. There are other low cost options which may be preferable to passive indexed investment. One example is a buy and hold strategy where a stable portfolio is built up and held for the long term. It is lower cost and lower turnover than passive indexed investment, but can offer higher returns. We use this approach for index linked gilts in our closed fund, and have considered it for our corporate bond exposure in the Active fund too. It has been used for equities too, notably by the BT pension scheme. Another is the use of liability driven investment, which holds bonds in a risk minimising way (typically seeking to mimic the cash flow of liabilities, rather than an arbitrary benchmark) – although still in a low cost way. To enforce passive investment over these options is without merit.

b. The range of indices and possible approaches to passive investment is very large – including numerous sub indices and a large number of specialist indices. Restricting passive investment options to just include the “standard” indices would be arbitrary and endorse the sub optimal nature of these indices. For the EAPF it would be particularly important to access some of the sustainable and environmental indices. Allowing a wider range of options would be better, but creates further anomalies, as many passive approaches can be clearly improved further by an active overlay and in some cases the distinction between passive and active can become blurred.

c. If a restriction on active investment is imposed then it should logically also cover a range of wider investment options which rely on active selection and manager skill, such as hedge funds, diversified growth funds, and absolute return fund – however, this would seriously inhibit asset allocation at funds. At the EAPF, we have generally preferred to use relatively unconstrained active managers rather than an alternative option with similar return potential of a combination of passive investment and hedge funds, as we regard it as cheaper and a longer term, lower risk solution.

Conclusion

This consultation contains some interesting proposals, but the EAPF feels it is too narrowly focused on costs and ignores many of the potential drawbacks. The EAPF is strongly of the view that the best way to address the issues identified is through freedom of competition and choice, supported by further progress on governance and professional standards in the LGPS. Key to this is our ability to;

- Continue to deliver £20-25m per annum (after fees, above its benchmark and a proportion managed passively) and deliver these savings to our employers through our funding strategy and thereby long term reductions in employer contributions.
- Use passive management extensively (30-40%) in the investment strategy to help with diversification and costs, but not be forced to further increase as this would unacceptably increase the financial and non financial risks to portfolio.

- Maintain our global reputation for being a leader in responsible investment. The increased use of passive would curtail our ability to manage risks in the portfolio from poorly managed companies, issues such as climate risk and considerably increase our reputational risk from investments in controversial companies.

The current proposals also risk limiting the discretion (through mandatory use of CIVs or passive investment) of administering authorities, which would undermine their fiduciary role and materially weaken accountability for investment decision making, Instead, we recommend that the LGPS investment regulations are replaced by a clear adoption of “fiduciary duty” on LGPS funds as recommended by the Law Commission’s report on the *Fiduciary Duties of Investment Intermediaries,* July 2014. This approach is the norm in the private sector, and has successfully underpinned private pensions for many years. It would not inhibit the use of CIVs and consideration of cost effective passive solutions, where appropriate.

Dawn Turner

Head of Pension Fund Management
Environment Agency Pension Fund
dawn.turner@environemnt-agency.gov.uk

2 July 2014