

Staff and Pensions Committee

14 December 2015

The Future of the LGPS

Recommendation

That Staff and Pensions Committee:

authorises the Strategic Director for Resources on behalf of the Pension Fund to submit an initial proposal to the Government's consultation, by 19 February 2016, that proposes a collaborative approach to pooling funds with Surrey, Cumbria and East Riding, subject to a further report for final decision being brought to Council before July setting out the arrangements in more detail.

1 Introduction

- 1.1 In the July Budget 2015, the Chancellor announced the Government's intention to work with the Local Government Pension Scheme (the Scheme) administering authorities to ensure that they pool investments to significantly reduce costs while maintaining overall investment performance. Authorities are now invited to submit proposals for pooling which the Government will assess against set criteria (see Section 2 below). The Chancellor has announced that the pools should take the form of up to six British Wealth Funds, each with assets of at least £25bn, which are able to invest in infrastructure and drive local growth.
- 1.2 On 25 November as part of the Autumn Statement a consultation was released which set out how authorities should pool assets and the criteria that should be considered. Authorities are asked to submit their initial proposals to the Government by 19 February 2016. Submissions should include a commitment to pooling and a description of progress towards formalising their arrangements with other authorities. Authorities can choose whether to make individual or joint submissions.

2. The Consultation

- 2.1 The consultation outlined four main criteria that submissions should take into consideration:

- A. Asset pool(s) that achieve the benefits of scale: the 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported.
 - B. Strong governance and decision making: the proposed governance structure for the pools should provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members.
 - C. Reduced costs and excellent value for money: in addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so are rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.
 - D. An improved capacity to invest in infrastructure: only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class.
- 2.2 Refined and completed submissions are expected by 15 July 2016, which fully address the criteria in this document, and provide any further information that would be helpful in evaluating the proposals.
 - 2.3 The July Budget 2015 announcement set out the Government's intention to introduce "backstop" legislation to require those authorities who do not bring forward sufficiently ambitious plans to pool their investments.

3. Work done to date

- 3.1 Noting that there has been limited time to undertake any detailed appraisal work, officers advising the Warwickshire Pension Fund have been open to consideration of all options either currently available or requiring construction that would ensure the Fund retains strategic management of asset allocation, but which may offer new opportunities or solutions to current initiatives, the driver being that an initial mover should be able to secure greater control than if the Fund is mandated to pool its assets nationally.

3.2 The key factors that officers have looked to address in any option to be considered are that:

- asset allocation strategy must be retained at an individual Fund level;
- any new structure should be capable of complementing a bespoke investment strategy for scheme employers with common characteristics;
- the Fund should retain a pivotal role in the governance of any pooled structure chosen;
- any partner must have a complementary investment ethos and strategy;
- any new structures should offer opportunities for savings, while retaining or improving on the Fund's current performance;
- the possibility to introduce internal management capability;
- any solution provides additional resilience and capacity over and above current governance structures;
- the structure chosen must be flexible so as to ensure assets are only transferred into any vehicle when/if it is efficient and effective to do so;
- any new structure must be scalable to ensure some level of future proofing;
- a solution will seek to provide internal shared resource to progress more proactive management of liability and cash flows.

3.3 Officers have participated in a large group data exercise administered by Hymans Robertson that will provide an analytical review and recommendations for future pooling and solutions. This has not yet provided a clear recommendation for a delivery solution.

3.4 Officers have also met representatives from West Midlands Pension Fund and neighbouring authorities to discuss regional pooling and how this could work in practice.

3.5 In addition, on 5 November it was announced that Pension Funds for East Riding, Surrey and Cumbria are in talks to launch an investment partnership, pooling £9bn in assets. Other Pension Funds with a similar profile were contacted following this press release with a view to joining this partnership in order that the required scale of £25bn can be met.

- 3.6 Officers advising the Warwickshire Pension Fund consider that the optimal solution would be a voluntary submission to Government as part of a group of other Funds sharing the objectives set out at 3.2 above.
- 3.7 Officers and section 151 officers have therefore met and held initial discussions about Warwickshire joining the East Riding, Surrey and Cumbria investment partnership outlined in 3.5 and believe that, out of the three options seemingly available to the Warwickshire Pension Fund at this time, this partnership offers the most appropriate solution as it will demonstrate:
- An understanding of the Fund's existing asset allocation particularly in the alternatives space, i.e. Private Equity and Hedge Funds.
 - The use of in-house investment where applicable
 - The sharing resources amongst Funds
 - A projection of realistic savings over the 15 year period through scale and direct manager selection
 - That Warwickshire would have a strong voice in the management and decision making of the proposed pool.
- 3.8 On November 27 the Chair of the Pension Fund Investment Sub-Committee met the Chair of Surrey's Investment Board. The outcome of this meeting was an agreement that Warwickshire respond to the Government consultation as part of the group outlined in 3.5

4. The Proposal

- 4.1 The proposal will be a pooled investment partnership in an Authorised Contractual Scheme (ACS) structure which has benefits over other structures and is the preferred choice of the Government. There will be the creation of a separate management company that will be wholly owned by the partner funds of the pool. Each of these funds would have an equal holding in the ownership of this company and an equal say in the governance of the structure.
- 4.2 The structure will offer the opportunity to deliver the required savings whilst maintaining or improving on investment performance. Savings can be achieved through scale and the ability to directly invest. There will also be the possibility to use the internal investment capability of the partner funds where appropriate.
- 4.3 It is important that the structure must have suitable flexibility so that assets are only transferred to the new vehicle at the point that it becomes tax efficient and beneficial to the pool to do so.
- 4.4 The structure must also offer solutions to access infrastructure investments to meet the criteria set out by Government.

- 4.5 This proposal is only at the early planning stage and views are being sought by the founding partners.

5. Next Steps

- 5.1 If the Staff and Pensions Committee approves the recommendation set out above then the next steps will be as follows:
- (a) officers, in consultation with the Pension Fund Investment Sub-Committee Members, to continue to work with the representatives of the proposed East Riding, Surrey and Cumbria investment partnership to prepare and submit a draft response to the Government's consultation by the deadline of 19 February;
 - (b) Members of the Pension Fund Investment Sub-Committee (and the Staff and Pensions Committee as appropriate) to scrutinise any response from Government and the emerging details of the proposed investment partnership;
 - (c) advisers to the Pension Fund to consider whether any consultation obligations are triggered by the proposed new pooling arrangements and to seek authority to undertake any consultation which may be so required;
 - (d) a report to be brought to Council for final approval setting out the proposed arrangements in more detail in time for the final submission to Government in July 2016.

Background Papers

1. DCLG Local Government Pension Scheme: Investment Reform Criteria and Guidance

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