

# briefing note

LGPS Pooling Update

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## LGPS investment pooling: responding to government

In the Summer 2015 budget, the government announced that local authorities should put forward proposals to “*pool investments to significantly reduce costs, while maintaining overall investment performance*”.

At the time, no more details were given but since July the government has been sharing its thinking through an informal dialogue with local authorities, fund managers and other interested parties. This two way exchange has included a series of “round-tables” and other meetings involving the DCLG and HMT teams responsible for the LGPS. We understand that an event aimed at elected members is likely to be held in October.

The purpose of this briefing note is to update you on emerging government thinking and how we are helping local authorities to respond.

### What criteria will be used to assess pooling proposals?

While government is continuing its informal consultation through dialogue with interested parties, based on what has been said so far, the primary criteria used to assess pooling proposals are likely to be:

- (i) **scale** (circa £30bn plus has been suggested as an illustrative figure although some flexibility around the exact figure is expected);
- (ii) **savings** (no figure has been put forward by government but we expect that this must be in the region of several hundreds of millions of pounds annually); and
- (iii) **governance** (for example, government wishes to stop manager hire and fire decisions being made locally, in the expectation that this will reduce the frequency and therefore the costs of manager change. However it accepts that investment strategy and asset allocation decisions should continue to be made locally).

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There may be secondary criteria including:

- a) **simplicity** - for example, the government might take the view that regional pooling looks simpler than other models for pooling. Anything that appears at first sight more complex would have to score more highly against other criteria, for example, by delivering greater savings; and
- b) **speed of delivery** – any approach that can deliver savings faster may be attractive. As an example, for some asset types (such as passive listed securities) it will be worthwhile exploring whether procurement without going through a Collective Investment Vehicle (CIV) could deliver the same savings faster and with less set up and running cost.

Inevitably whatever other criteria are used to assess pooling proposals, there may be **political factors** which will be factored into government thinking.

#### What else do we know so far?

Other points emerging from the informal consultation so far include:

- **There will be no exemptions** – All funds must participate in pools;
- **Role of internal management** – Internal management already covers more than £30bn of LGPS assets across around 15 funds. If there are no exemptions from pooling, it may be that the internally managed funds will be asked to show how they collaborate in some way to meet the requirement for pooling;
- **Procurement instead of CIVs?** – “virtual” pooling using procurement or procurement frameworks may be acceptable for some asset types where this can deliver the same savings faster and with lower cost and complexity than “physical” pooling using CIVs. However, work is needed to show how this can be done in a way that squares with the government preference that choice of fund manager should no longer be a local decision;
- **Flexibility to invest some money outside of pools** – The government may be open to local authorities making the case for allowing freedom to invest some money outside of pools. This might be useful for local investment or for special situations needing investments not catered for through pools ;
- **Individual funds will continue to decide their own investment strategy** – The government has confirmed that investment strategy and asset allocation decisions can remain with individual funds but it needs input on the details of exactly which decisions should remain local and which should be made at pool level;
- **Timing** – We understand that proposals will need to be submitted to government early in 2016 to help inform a further statement in the next budget. Government is aiming to see new pooling arrangements in place and money invested within this parliament. It accepts that it may take longer for all of the savings to emerge; and
- **Quantification of savings** – The government wants to see quantification of expected savings from proposals submitted. After pooling arrangements are implemented, it will monitor actual savings emerging.

### What pooling models might be considered?

The government has not proposed any specific pooling model so far. Pooling options might include:

- 1 **a regional model:** government considers regional pools to be a simple starting point against which other pooling proposals should be measured;
- 2 **a regional “plus” model:** regional pools complemented by some LGPS wide pools for particular asset classes (for example, infrastructure investment may be accessed more efficiently via a LGPS wide pool);
- 3 pools based on **asset types**; and
- 4 **mixed approaches** (including regional, asset type pools, internally managed pool(s), physically pooling via CIVs and virtual pooling by procurement where CIVs add unnecessary cost and complexity).

### Helping government to see the big picture

We expect government will receive proposals on a variety of specific initiatives (regional CIVs, procurement initiatives, internal management, etc). These will be useful, but the government will have difficulty assessing any of these in isolation without understanding how they fit together and whether there are overlaps or gaps. It might also be difficult to identify whether claimed savings have been quantified in a consistent way and whether there is any double counting of savings across proposals.

Hymans Robertson has therefore offered to support a group of local authorities who will collaborate in preparing a joined up report which will narrow down the range of potential pooling options to a small number (expected to be circa 2 or 3 and including regional and mixed approaches) and assess these against government criteria. It will also cover matters such as the role of internal management in a pooling framework, and explain how procurement may be an appropriate way of achieving pooling for some asset classes.

The participating funds will draft the report and agree the conclusions. Hymans Robertson will support the work in a number of ways including data analysis and quantification of savings.

The group of participating funds represents a broad church in terms of preferred approach, local interests and expertise including:

- Counties, and Mets
- internally and externally managed funds
- experts in responsible investment, procurement frameworks and setting up CIVs

Some of the participants are also working separately on specific initiatives (including ideas for regional pools, pooling by procurement and internally managed pools). We believe the report will complement the work of those groups.

The timetable is challenging. The group’s plan is for a draft report to government to be ready by Christmas. To help spread the workload the funds participating in the project would welcome support from others who have expertise and experience in some of the matters that need to be examined.

### Conclusion

Government requirements are becoming clearer. There are some things that the government is unlikely to move on. For example,

- there will be no exemptions from pooling, and
- all local decision making on manager selection will come to an end.

However, there is much that is undecided and where the government is open to ideas. For example,

- whether pools should simply be regional, or
- whether other approaches could have greater benefits.

What is clear is that anyone still holding on to the hope of status quo is likely to be disappointed. In the short time that is available, it is important that funds work on constructive proposals to help shape the outcome. However it would potentially be premature to get to the stage of sinking a significant level of cost into a new initiative before the government has had a chance to review all of the proposals submitted and deliberate on the best way forward.

We will be supporting local authorities to help deliver an authoritative, evidence based proposal to help the government to see the big picture and make the best decisions for the long term future of the Scheme.