:
**Regulatory and Other Committee**

**Open Report on behalf of Executive Director of Finance and Public Protection**

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| Report to: | **Pensions Committee** |
| Date: | **07 January 2016** |
| Subject: | **LGPS Asset Pooling** |

**Summary:**

This paper updates the Committee on the Government's requirements on pooling LGPS assets, following the publication of the pooling criteria and investment regulations consultation on 25th November 2015. In addition, it details the preferred pooling route for the Lincolnshire Pension Fund.

**Recommendation(s):**

That the Committee
i) note the report;
ii) agree the principles for pooling outlined at paragraph 1.7 in the report; and
iii) delegate authority to the Executive Director of Finance and Public Protection, in consultation with the Chair and Vice Chair of the Pensions Committee, to respond to the Government's consultation and pooling requirements.

## Background

### 1 Asset Pooling

1.1 The Committee have been kept updated since the summer budget speech in July on the Governments desire to pool pension fund assets. In his speech on the Comprehensive Spending Review on 25th November 2015, the Chancellor announced the release of the awaited consultation on pooling. Para 1.138 states: "*The government will today publish guidance for pooling Local Government Pension Scheme Fund assets into up to 6 British Wealth Funds, containing at least £25 billion of Scheme assets each. The government is now inviting administering authorities to come forward with their proposals for new pooled structures in line with the guidance to significantly reduce costs while maintaining overall investment performance, with the wider ambition of matching the infrastructure investment levels of the top global pension funds*".

1.2 The Committee was emailed the criteria and consultation documents on 9th December, along with a briefing note form the Fund's consultant, Hymans Robertson.

1.3 The criteria for pooling assets, and not subject to consultation, are:

a) Achieve the benefits of **scale** – up to 6 asset pools of £25bn or more. *Given that the London Funds have already created a pool, and Welsh Funds are expected to be a standalone pool, this potentially only leaves 4 pools for the rest of the County (48 Funds). It is expected that most assets will transfer in a pool, and any that remain outside must have a clear rationale for not pooling (e.g. direct property with the costs of transfer or closed ended funds that will run off over the coming years).*

*b)* Strong **governance** and decision-making – investments should be managed appropriately by the pool with risk adequately assessed and managed. The pool should have appropriate resources and skills. The Local authority will hold the pool to account. *This removes the investment manager decisions from the Pensions Committee and places them with the pool – the Committee will retain asset allocation decisions.*

c) **Reduced costs** and excellent **value for money** – pools need to deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining investment performance. *Overall savings will be measured against the Hymans report of last year, indicating a potential collective figure of around £600m p.a.*

d) An improved capacity to invest in **infrastructure** – proposals should show how the pooling arrangements will enable the funds to invest more in infrastructure. *Whilst not specifically referring to UK infrastructure, this is seen as the ultimate aim.*

1.4 The consultation requires an initial "suitably ambitious" but well-structured proposal for submission to Government by 19th February 2016, detailing our commitment to pooling, describing our 'progress towards formalising arrangements with other authorities'. These submissions can be at individual Fund level or pool level (if Funds have agreed), or both. It is expected that a considerable amount of detail and thought will have gone into these submissions and that they are more than just a direction of travel.

1.5 Following receipt of these, it is expected that Government will respond as to whether they are acceptable proposals or not, and those Funds that have not partnered may be directed to join certain pools.

1.6 The second stage is required by 15th July 2016. This final submission must fully address the criteria set out above, with enough information for the proposal to be fully evaluated by government. Each pool must make a submission which covers the joint proposals and describes the proposed governance, structure and implementation plan. Each authority must also submit an individual return which sets out the profile of costs and savings, for up to 15 years ahead, the transition profile for the assets and the rationale for any assets which it proposes to hold outside the pool.

1.7 As a Fund, we have had meetings with a number of potential pooling partners, to assess their suitability. It is important that any partners we pool with have similar investment principles and beliefs (sometimes referred to as "like-minded"). It is suggested that the main principles the Lincolnshire Fund believes are important are:

- Every Fund in a pool will have an equal voice in the pool, regardless of size.

- Internal management capabilities are beneficial and reduce costs, however, in a pool these must sit separately from the Funds and must be FCA regulated and subject to the same due diligence as any external manager.

- Any local investment must meet the minimum investment criteria of the pool and provide an equal or greater return (on a risk adjusted basis) than can be found elsewhere in the market.

The Committee is requested to adopt these principles to assist in selecting an appropriate pooling arrangement.

1.8 The pools that we have met with are set out below, with observations as to how they would fit with Lincolnshire.

- "Northern Powerhouse" – West Yorkshire, Greater Manchester and Merseyside Pension Funds have publically declared they are working together, this will create a pool of around £40bn. They are in discussion with a number of smaller funds around them and are very vocal about their passion for local investment, particularly along the M62 corridor.  This will have internal management capacity, but the internal teams are expecting to stay located with their current Fund, and manage other funds through delegation powers rather than becoming FCA regulated.  This is not seen as a suitable pool for Lincolnshire.

- Midlands Pool – West Midlands, Derbyshire, Cheshire, Shropshire, Nottinghamshire, Staffordshire, and Worcestershire have publically announced that they will join together as a £35bn pool.  This will have internal management capacity, but the internal teams are expecting to stay located with their current Fund.  This is not seen as a suitable pool for Lincolnshire.

- ACCESS – Northamptonshire, Cambridgeshire, Essex, Isle of Wight, Hampshire, Buckinghamshire, Norfolk and some other Funds are in discussion.  So far two meetings have been held and a number of the Funds that attended are also in discussion with other Funds.  No real progress has been made yet.  This will not have internal management capacity.  It is not yet known what size the final pool will be.  This is not seen as a suitable pool for Lincolnshire.

- Border to Coast Pensions (working title) – East Riding, Cumbria, Surrey and Warwickshire have publically declared their intent to pool, and a number of other Funds are in detailed discussion with them, but have yet to go public.  The three Funds at East Riding, Cumbria and Surrey have been working on a proposal since the budget announcement in July, and have put considerable thought into who they would wish to partner with and how that structure might work.  If all funds that they are speaking to progress, this will be around £32bn (with 10 Funds) so will meet the target size.  The draft investment principles that have been draw up are aligned to Lincolnshire's principles.  This is seen as the most suitable pool for Lincolnshire to join.  Officers have spent time researching what governance options are available, the optimal regulated pooling structures and high level legal, tax and audit matters that need to be considered when constructing an asset pool of this scale and complexity.  Given the work that has already been undertaken, and that which is planned over the coming weeks, this pool will be able to submit a considered and "suitably ambitious" proposal in time for the Government's deadline.

1.9 Therefore the preferred pool for the Lincolnshire Pension Fund to work with is the Border to Coast Pensions pool, as a founding member, ahead of the February proposal deadline. Within any of the pools it will be the founding members that will be able to input into and agree the governance structures that will be followed by the pool. Coming into a pool at a later date will mean that such input is difficult, as important decisions will have already been made, to ensure that the proposal is acceptable to Government.

## 2 Impact on the Committee

2.1 How does this change impact the Committee? Actually, very little. The only area that changes for the Pensions Committee is manager selection. The important aspects of managing the Pension Fund will all stay with the Committee; the asset allocation (e.g. how much in equities or bonds, how much in UK or overseas), the administration of the benefits, and the Fund governance. The Pool will manage the investments of the Fund, and the manager selection, in the asset allocation set by the Committee. The Pool will be responsible for the manager choice, but will be accountable to the Fund for poor investment decisions. The Pool will report to the Fund on the performance of its investments, rather than the manager presentation meetings that are currently held.

## 3 Proposed Changes to the Investment Regulations

3.1 Complementing the Guidance on responding with a suitably ambitious pooling proposal, a consultation has also been issued on replacing and revoking the LGPS (Management and Investment of Funds) Regulations 2009. The aim of the new regulations is to lift existing restrictions on LGPS fund investment powers in order to make it easier for them to pool investments and access benefits of scale. The core principle has been to move to a prudential approach securing a diversified investment strategy that appropriately takes account of risk, as is done in the private sector. The consultation on the new regulations ends on 19$^{th}$ February 2016, alongside the requirement to submit first stage pooling propositions.

3.2 The proposals in this consultation paper seek to address the restrictive nature of the previous investment regulations, placing the onus on authorities to determine a diversified investment strategy that appropriately takes risk into account. The draft regulations recognise that in relaxing the regulatory framework for scheme investments, it is also important to introduce safeguards to ensure that the less prescriptive approach proposed is used appropriately.

3.3 The safeguard within the Local Government Pension Scheme (Management and Investment of Funds) Regulation 2016 is in draft regulation 8(2)h, which introduces a new power to allow the Secretary of State to intervene. This is intended to ensure that LGPS funds take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance. The new power would enable the Secretary of State to issue Directions to individual funds. These may require the Fund to develop a new investment strategy statement, or invest all or a portion of its assets in a particular way more closely adhering to the Criteria and Guidance. Alternatively, it is suggested that the Secretary of State may personally intervene by executing a fund's investment functions, or by directing a third party to implement a fund's investment strategy. This type of "backstop" legislation is often found when the government deregulates.

## 4 Recommendation for delegated authority

4.1 Given the timescale in which a response is required (by 19th February 2016), it is requested that authority is delegated to the Executive Director of Finance and Public Protection, in consultation with Chair and Vice Chair of the Pensions Committee, to submit a response to the consultation on investment regulations and respond, either individually as a Fund or as part of a Pool, with a "suitable ambitious" proposal for asset pooling.

## Conclusion

5 The Government has published its long-awaited paper on asset pooling and updating the investment regulations. The criteria for pooling have been announced, and funds are asked to submit "suitably ambitious" pooling proposals by 19th February, the same date that the consultation on the investment regulations closes.

6 Delegation of authority is requested to allow the Executive Director of Finance and Public Protection, in consultation with Chair and Vice Chair of the Pensions Committee, to prepare and submit the responses required.

## Consultation

### a) Policy Proofing Actions Required

n/a

**Background Papers**

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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