

By: Chairman Superannuation Fund Committee
Corporate Director of Finance & Procurement

To: Superannuation Fund Committee – 6 November 2015

Subject: **LGPS POOLING PROPOSALS**

Classification: Unrestricted

Summary: To give an update on the recent Government announcements and local authority work streams.

FOR DECISION

INTRODUCTION

1. In his June budget the Chancellor of the Exchequer said:

“Local Government Pension Scheme pooled investments – The government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments”.

The report will set out the current understanding of what this means and decisions needed at this point.

CURRENT POSITION

2. Over the last couple of years of the Coalition Government there were a variety of attempts by the Department for Communities and Local Government (DCLG) to instigate significant change in how the LGPS operated. These were:
 - 2013 Call for Evidence.
 - The amalgamation of all the existing funds into 5.
 - Compulsory investment in infrastructure.
 - Compulsory use of passive management

It is probably fair to say that none of these enjoyed very much support from administering authorities.

3. It does seem that the Government seem to think there are fundamental problems in how the LGPS as a whole operates. But they have done little to set out what they think these are and there appears to be a tension between DCLG generally proposing more devolution to local authorities and the Treasury seeing cost savings as the major issue.
4. DCLG and Treasury have sought to work through the Local Government Association Head of Pensions who is the former Head of Pensions Administration at the London Pension Fund Authority (LPFA). This then led to a number of officer meetings for a small number of selected funds with CLG and Treasury officials. CLG indicated that they were looking for proposals from administering authorities aimed at creating 5 large pools of assets. Individual funds would remain and decide what assets to invest in and continue their other functions but they would no longer select and appoint investment managers.
5. The argument that authorities should be working together to reduce costs is a powerful one but it is also massively simplistic. We know that there is no one investment manager or investment style which works in all circumstances and therefore funds need to spread assets between managers. Whilst collaborative approaches could work, compulsion and the complete removal of any powers for authorities to appoint any fund managers themselves are overly restrictive. There are three prime examples of this for Kent:
 - Investment manager fees- the average investment manager fee for the Fund is 0.3% which we believe is substantially below average. This in part reflects some very long standing arrangements with investment managers who have very large mandates. Potentially we could end up paying higher fees in a pool.
 - Property investment- attached in Appendix 1 is a response to DCLG on why Property should not be included in these arrangements.
 - Woodford UK equities- Kent is the only local authority pension fund invested with Woodford and the Fund has hugely benefitted from appointing Woodford, as it did from his time at Invesco. Given the style of investing it is unlikely that Woodford would be selected to manage a UK equity pool and so we could potentially be forced to end the mandate.
6. The Kent Fund has been run by a highly experienced set of members and officers which has provided a stable basis for decision making. It is clear that this is not the case across the board in the LGPS and there are a core of funds who never add any value. Overall action by DCLG to address these funds would be more productive than a blanket compulsion which will throw aside arrangements in many large funds which work very well. A briefing paper for the Leader in his role as Chairman of the County Councils Network is attached in Appendix 2.

7. At the current time there are no defined timelines but from the information available an expected timeline is:

Government to commission and receive advice from to help set the “common criteria”	Aug – Oct 2015
Consultation (and the backstop enforcement regulation)	Early Nov 2015
Consultation response from all stakeholders (expectation is for 12-week response period)	Early Feb 2016
Draft Regulations published	March 2016
Effective date	April 2016
Creation of asset pools (phased in over three years)	April 2019
Transition of assets for those funds not meeting the ‘common criteria’	Unknown

8. A number of different work streams and initiatives have been launched in the wake of the DCLG meetings and the main ones are:

- Hymans Robertson- Hymans not surprisingly as a leading player in the LGPS actuarial and investment consultancy business have formed a group of around 25 authorities who they will work with to develop options. There was no authority to join this group but Kent is providing data to Hymans that they have requested on investment mandates and fees.
- Meeting with administering authorities in the SE7 Group- the Head of Financial Services met with officers from Hampshire, Surrey, East Sussex and West Sussex at which Hymans presented. Even amongst these five Councils there are very large variations in how they manage the funds and very different views on how to respond to the pooling issue.
- LPFA/Lancashire- these two funds have joined forces to share resources to manage the funds and to co-invest. They are looking to manage equities internally and to do more infrastructure investment. Investments will be focused on London and pensions administration in Lancashire. I would expect them to look to sell services including investment management to other authorities.
- London Collective Investment Vehicle- this has been underway for a couple of years and covers the 31 London Boroughs but not the LPFA. The initial fund managers are those which were most common amongst the London Boroughs so Baillie Gifford will be the first manager to receive funds. It’s believed that through commonality along this will capture £5-10bn of assets. The CIV arrangement excludes the LPFA. It may be possible for other authorities to join.

- Passive Equity Framework- Norfolk Pension Fund has taken the lead over the last couple of years in setting up the National LGPS Frameworks which other authorities can access. Kent appointed Northern Trust as fund custodian through a Global Custody Services Framework contract. The National LGPS Frameworks team at Norfolk have launched an initiative to set up a national framework for passive equity managers and members are asked to support this proposal. A group of funds appointing a passive equity manager or managers on a collaborative basis would achieve exactly the sort of outcome that the Government is looking for but without new regulations or compulsion.
- Chancellor's announcement- The Chancellor of the Exchequer at the beginning of October made announcements which seemed to suggest that a small number of funds would be created and once again raised the issue of Infrastructure investment. The DCLG response to this is in Appendix 3.

KENT RESPONSE

9. From earlier discussions the Committee has not felt that there is a need for radical change in how the Kent Fund is managed. An awareness and an interest in working with others is healthy but the element of compulsion would be totally contrary to how the Fund has operated. It is also contradictory to the quasi trustee role which members of the Committee hold. There are a range of possible responses:
 - Lobby DCLG against the proposals and stay outside any of the initiatives- we could seek to influence outcomes through the lobbying and not support initiatives which we don't think will work.
 - Participation in collaborative procurements arrangements - these can achieve substantially the objective the Government is looking for of reducing fees. The passive equity framework would be an example of this. We could look in future to jointly procure any investment mandates. But this would be on a wholly voluntary basis. Such virtual pools could meet DCLG requirements.
 - Participate actively in setting up pooled vehicles or Collective Investment Vehicles- these could be new vehicles or the London CIV. New vehicles will be quite costly to set up and the governance arrangements would need to be satisfactory. They will mean much more remote influence over manager selection and monitoring and potentially not being able to disinvest when we lose confidence in a manager.

- Work with other funds to create a joint investment management vehicle - with this option the investments would be combined with other funds and managed by an in house team. This would be a major undertaking as we would need expertise on compliance issues (it would need Financial Conduct Authority authorisation), risk management and IT systems. This does look awfully close to setting up our own investment management organisation. The new entity would appoint and monitor investment managers and we would have a role on a managing board. Given that one of the issues for the LGPS is that there are already far too many investment managers to choose from the idea that the answer is for administering authorities to set up their own investment vehicles does seem counter intuitive.
10. There is also a difficult line to determine between participating in the development of solutions which the Committee does not feel are optimal and standing outside of the discussions and therefore having little or no influence on the outcome.

RECOMMENDATIONS

11. The Committee is asked to agree to the following:
- (1) Allow officers to participate in ongoing discussions with other Funds which will be fully reported to the Committee.
 - (2) Endorse participation in the National LGPS passive equity framework tender process.
 - (3) Delegate responsibility to the Corporate Director of Finance and Procurement the preparation of a response to any formal consultation document from DCLG in consultation with members.

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