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| By: | Chairman Superannuation Fund Committee<br>Corporate Director of Finance & Procurement |
| To: | Superannuation Fund Committee – 5 February 2016 |
| Subject: | **LOCAL GOVERNMENT PENSION SCHEME POOLING PROPOSALS** |
| Classification: | Unrestricted |

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Summary: To update on the LGPS pooling work and seek decisions on pool membership and a response to DCLG's consultation paper.

**FOR DECISION**

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## INTRODUCTION

1. This report updates the Committee on developments since the last meeting on LGPS pooling. The proposals published by the Government in November 2015 present the most radical changes to the management of the LGPS since it was first established. It is clear that the Government is absolutely committed to the pooling proposals and so our task is to influence them as far as we can to ensure the proposals are sensible and position ourselves to best protect the interests of the Kent Fund moving forward.

## LGPS INVESTMENT REFORM CRITERIA AND GUIDANCE

2. Given the importance of the document the DCLG paper is attached in full in Appendix 1.

3. The main issues are:

   (1) Six "British Wealth Funds" (multi asset pools for the purpose of this report) are to be established each with assets of at least £25bn.

   (2) There will be governance arrangements at pool level involving members to oversee the pool investments.

   (3) The target date for establishing the pools is 1 April 2018. We envisage that existing mandates would transfer and after that date processes would commence over an extended period to move funds into new mandates.

(4) The paper states that “backstop legislation that would require those administering authorities who do not come forward with sufficiently ambitious proposals to pool their assets with others”. This is a very clear statement of intent from Government, that pooling will happen.

(5) There will be some investments such as close ended funds which will not be included in the pooling arrangements.

(6) Direct Property is excluded and this is a major move from DCLG’s initial position and is the right answer from an investment perspective.

(7) The proposals leave all the other responsibilities of this Committee unchanged. This Committee will still decide which assets the Fund invests in and all other issues related to the management of the Fund.

(8) Greater investment in Infrastructure.

4. Initial responses are required by 19 February and full costed responses by 15 July.

**POOLING OPTIONS**

5. At the last Committee meeting it was agreed that the Head of Financial Services should participate in discussions with other Funds. The Chairman, the Deputy Leader and Cabinet Member for Finance & Procurement and the Corporate Director of Finance and Procurement have been kept fully informed of these discussions. All discussions have emphasized that decisions on the way forward are for this Committee.

6. Hymans Robertson had already facilitated a working group of around 25 non-London funds including the largest LGPS funds and a number of County Council funds. Project Pool had a formal structure and a number of sub-groups and the Head of Financial Services participated in the high level pooling workstream. A report should be published before the Committee meeting and this will represent the group of Funds views on how pooling can best be implemented.

7. This work showed that Funds are coming at the pooling issue from many directions and with many different objectives. In the Hyman’s work frequent reference was made to the need for Funds to be “like minded” and this will be an issue that we return to.

8. In summary the main findings of the Project Pool work are:

(1) Preferred option multi-asset pools formed by region and like minded group.

(2) For most asset types, regional pools may give sufficient size to get the majority of scale benefits / fee reductions.

(3) Regional or like minded groupings also give individual funds more involvement in the governance of pools.

(4) For Infrastructure a national pool may be the best answer.

(5) Savings will be exceeded in the early years by the costs of setting up the pools and then by the potentially very large transaction costs.

9. Whilst the Hymans work concentrated on the "what" of pooling individual Funds seem to move very quickly to the "who". This is not a helpful emphasis and it is one which reflects the different agendas Funds have. The main groupings to emerge are:

(1) London Collective Investment Vehicle (CIV) (£24bn) – 31 London Boroughs have been working on this project for the last 2 years. It is seen as the way forward on pooling for London Boroughs. To date this has been a voluntary project but it will become mandatory under the pooling proposals.

(2) M62 (£50-60bn) – dominated by some very large funds including West Yorkshire, Greater Manchester and Merseyside. Includes a large amount of internal management.

(3) Central (35-£40bn) – Midlands funds including the very large West Midlands Fund.

(4) ACCESS (£30-38bn) – Central, Eastern and Southern shire county funds.

(5) South West (£20-24bn) – South West Funds including the Environment Agency who have been working together and have a strong ESG focus.

(6) Border to Coast (£13-17bn) – a disparate geographical group consisting of Surrey, Cumbria, East Riding and Lincolnshire.

(7) London Pension Fund Authority / Lancashire (£12-16bn) – apparently seeking to set up an in house investment management business and sell services to other funds.

(8) Wales (£15bn) – a logical geographical grouping but too small to meet Government requirements.

10. The Head of Financial Services will give an assessment of these options at the meeting. From his discussions with Funds it was clear that by far the best fit for Kent was the ACCESS group and the Chairman, the Deputy Leader and Cabinet Member for Finance & Procurement and the Corporate Director of Finance and Procurement agreed that subject to the decision of the Committee that Kent should enter into more detailed discussions with this group. At the current time the core members are West Sussex, Essex, Suffolk, Norfolk, Cambridgeshire and Northamptonshire. A number of other Funds have been attending the meetings but have taken no final decision – Hampshire, East Sussex, Hertfordshire and Bedfordshire.

11. The recommendation to work with ACCESS is based upon:

    (1) A genuine “like minded” approach and commitment to work collaboratively.

    (2) Similar investment strategies and a significant level of overlap of investment managers.

    (3) Currently no internal investment management activity. This has been a difficult issue in discussions with 8 of the larger funds in the Midlands and North very committed to internal management which others find highly unconvincing.

    (4) All County Council Funds with no standalone authorities.

    (5) No “agendas” such as setting up investment management business to sell to other Funds.

    (6) No one dominant Fund in terms of size.

    (7) Some geographical rationale which will assist in holding meetings and doing business.

12. If pooling is to happen the Fund needs to exercise the greatest influence that it can over how the pool operates. This is best done through working with “like minded” funds and reaching the £25bn requirement with the least number of participants. The ACCESS group seems to offer the Fund the best opportunity.

13. If the Committee agrees to participate in the ACCESS group we will then start an intensive period to have fully costed proposals to meet the 19 July deadline for responding to DCLG.

14. Beyond that there are very substantial issues for the pool to agree including:

    (1) Governance arrangements – one vote, one fund or weightings to reflect size. As the ACCESS group currently stands the main contributions to the cost savings that all member funds will achieve will be Kent and Essex representing 40% of the pool’s assets.

(2) Legal requirement – it will be highly complex to set up Financial Conduct Authority approved investment vehicles which assets can be transitioned into for 1 April 2018. Evershed's presented to ACCESS officers and achieving the most efficient investment vehicles will be a very significant task.

(3) Advisers – investment consultants and legal advisers primarily. These need to be properly procured and the costs are likely to be significant with little in the way of compensating savings at Fund level.

15. Committee is requested to approve expenditure on professional advisers which will be reported to each meeting.

**RESPONSE TO DCLG**

16. A draft response is attached in Appendix 2 which does seek to be a positive one, focusing on where we may be able to influence DCLG in how the proposals develop.

**RECOMMENDATIONS**

17. The Committee is asked to:

(1) Agree to work on the basis that ACCESS group is the preferred option.

(2) Authorise expenditure on professional advisers.

(3) Agree the response to DCLG.

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