

Local Government Pension Scheme - Statutory guidance on asset pooling

Introduction

The 11 LGPS Administering Authorities of the ACCESS pool have collectively chosen to provide this joint response to the Government's consultation on revised LPGS pooling guidance. The Authorities hope that the Government finds it helpful to receive a single consolidated response from ACCESS on the key points it has identified from the consultation, which further underlines ACCESS' effective partnership approach.

Approach and legal basis of the consultation

ACCESS has serious concerns about the way that MHCLG has approached the consultation and implications should the current draft become Statutory Guidance. These concerns have been confirmed by legal advice that the ACCESS authorities have commissioned, and therefore ACCESS feels that MHCLG should withdraw the current consultation and reconsider its position. In particular ACCESS would draw MHCLG's attention to the following:

- The manner in which MHCLG has consulted on the Draft Guidance does not comply with the Cabinet Office Principles for Consultation set out in 2018 in respect of the consultees, the lack of a cost benefit analysis and the fact that it appears that MHCLG has reached certain conclusions before consulting on which it should properly be asking questions as to alternative options.
- That the Draft Guidance undermines the powers of investment that are given to Administering Authorities under the 2016 Regulations, that an 'Authority may appoint one or more investment managers to manage and invest fund money, or any part of such money, on its behalf'. This may be being overridden by paragraph 3.2 of the Draft Guidance states that "Pool members must appoint a pool company or companies to implement their investment strategies".

The legal advice obtained by ACCESS is that it is unlawful for statutory guidance to make changes to a statutory instrument, because such changes may only be made by either primary or secondary legislation and not by guidance (*Medical Justice and Others v Secretary of State for the Home Department* [2017]).

As a result of these issues it is the view of the ACCESS Authorities that the Government should withdraw the current Draft Guidance, and if necessary propose an amended version, in line with the Cabinet Office's Principles. With that in mind the remainder of this response comments on current Draft Guidance in order that MHCLG can consider these views in future on the points raised in the Draft Guidance.

Status of the 2015 Guidance, particularly Value for money criteria

The ACCESS funds are extremely concerned that MHCLG proposes that the original 2015 pooling guidance is replaced by new guidance given that the 2015 guidance has been the basis of all of ACCESS decisions to date, and in particular that the original pooling criteria of 'value for money' does not continue to feature in the Draft Guidance.

The guidance correctly identifies that *'Members of Pension Committees are elected representatives with duties both to LGPS employers and members, and to local taxpayers... [and] have legal responsibilities for the prudent and effective stewardship of LGPS funds'*. While the guidance states that *'LGPS benefits are not dependent on their [local pension committees'] stewardship'* critically the cost of those benefits to scheme members are, therefore the value for money of each funds' and pools' investment arrangements remain important and a key part of the discharge of pension committees' fiduciary duty, and should remain a fundamental pooling criteria.

Based on the legal advice ACCESS has obtained, the draft text of paragraph 4.4 is incorrect in asserting that there should be consideration 'of the benefits across the pool and across the scheme as a whole'.

In the context of Regulation 53 of the Local Government Pension Scheme Regulations 2013 the authority can only administer and manage its fund in relation to those persons for whom it is the relevant administering authority. ACCESS' legal advice is that the law has long established that those who exercise powers on behalf of public bodies, such as local authorities, while not being trustees in a formal sense (because there is no trust) do have a quasi-fiduciary responsibility towards the funds under their stewardship. In an opinion obtained from Nigel Giffin QC by the LGPS Scheme Advisory Board in September 2014 that the LGPS 2013 Regulations should be interpreted as meaning that "the administering authority has to manage the fund by paying out of it the benefits to which members are entitled, but not as imposing an obligation to pay those benefits by other means" (paragraph 16(v) (emphasis added)). The connections between the power of investment given to authorities in the 2016 Regulations, the funds held by those authorities and their payment obligations are therefore inextricable.

Since the original pooling guidance in 2015 ACCESS' work has identified that there are net savings that can be achieved through pooling in investment managers fees and costs. This has been reported to the Government and been received positively. ACCESS has also reported that it has a programme of work to implement pooling and achieve these savings, which is already well underway.

Nonetheless the work to date has also highlighted that in a number of instances individual authorities have already achieved very competitive fees, and in some instances little to no further saving can be achieved through pooling, which is recognised in the Draft Guidance in paragraph 5.4. However, the guidance should acknowledge that despite regular review, the on-going benefits of pooling over the long-term may never outweigh the costs and assets may remain outside of the pool indefinitely as a result of any authorities' fiduciary

judgement that this is the best value for money outcome for its members. As such the heading for paragraphs 5.4 and 5.5 should have word 'temporary' removed and the definition of a 'retained asset' should be amended as follows 'an existing investment allocation retained by a pool member ~~during the transition period~~'.

This situation applies specifically to direct property investments which is correctly acknowledged in paragraph 5.5, which ACCESS is pleased reflects its July 2016 business case to the Government (the relevant extract is repeated in Appendix 1 for reference). Further clarification on the retention of assets outside the pool must however be included, in particular with regards to direct property investments. Unlike other asset classes, direct property will not 'mature' (as described in paragraph 5.4) and ultimately become available for investment in a subsequent pooled solution. In addition to maximise investment returns and for efficient portfolio management new direct property investment will continue to be made within existing strategic allocations, whilst new allocations will be made within the pool when suitable options are available.

Structure and definitions

The Government should ensure that the guidance takes account of the variety of pool operating models, as it currently appears to be largely written for the circumstance where 'pool companies' are wholly owned by the pool members, rather than the 'pool company' being a third party awarded a contract by the 'pool members'. Paragraph 3.2 correctly states that 'pool members' may appoint more than one pool company. The guidance should recognise more clearly that multiple 'pool companies' may be appointed to provide 'pooled vehicles/funds' to the 'pool members' and to provide the investment management of those assets. This could include passive investments through life funds, or infrastructure and other illiquid investments. This is no different to the provision of internal investment management by wholly owned 'pool companies'.

As an example MHCLG is aware that the ACCESS authorities have let contracts to UBS for the management of ACCESS passive investments, which have saved £5.1m per annum, and for which ACCESS was complimented by the Minister at our recent meeting. ACCESS has therefore assumed that the Government would want to treat these savings as a pool saving. The decision on the award of these contracts was made by ACCESS and the ongoing management of the contract and investments will be under the pool's governance, not individual authorities, thereby meeting CIPFA's definition, and as such will be reported as a 'pool asset', which should be reflected in the guidance.

ACCESS will continue to consider using a small number of different providers as pool companies as it believes that this is potentially the most cost effective means of the pool members accessing different asset classes.

Active and passive investments

The ACCESS authorities are pleased that the guidance continues to reflect that strategic asset allocation remains the responsibility of individual administering authorities. As such the decision to invest in active or passive investments will be determined by each

administering authority based on their individual assessment of the suitability of the investments and approach to risk [Regulation 7(2)(b & c)] in their Investment Strategy Statement. The effectiveness of both active and passive investment is already being closely monitored by each authority as part of the ongoing management of their pension fund. The decision to invest in either active or passive investments is not a pooling issue and therefore paragraph 3.6 should be removed from the guidance.

Reporting

As stated earlier in this response the Government must ensure that this guidance reflects both pooling models where the 'pool company' is a third-party provider or wholly owned by the pool members. As such paragraph 8.8 should either be deleted or clarified that it only applies to wholly owned pool companies. Third-party pool companies will not produce annual reports that are relevant to LGPS investment pooling.

The preceding paragraphs of section 8 are correctly worded. ACCESS' contracts with its pool companies ensure that they report the pool members in line with the SAB Code of Cost Transparency (paragraph 8.7), which will be the basis of the administering authorities annual reports produced in accordance with CIPFA's guidance, which can be collated by the SAB (paragraph 8.6).

Appendix 1

Extract from ACCESS' July 2016 business case for investment pooling

Direct portfolios are designed to account for target holding sizes, to reflect the total portfolio size and achieve the required levels of diversification. To move these holdings to part of a bigger direct portfolio would have significant cost implications, such as Stamp Duty Land Tax (SDLT), in order to reshape portfolios to meet new objectives which would be inconsistent with the value for money objective.

The cost analysis also shows that the direct mandates are the most competitive in terms of value for money. A Pool approach that met all the participating authorities' requirements would result in higher costs initially, given it would need to be a mix of direct and property fund holdings, until a more efficient solution can be developed.

Project Pool analysis showed that increasing direct mandate size does not result in incremental costs savings.