

### Analysis of the Government Policy, Criteria and Consultation LGPS - Future Investment Pooling Collaboration

#### 1. Chancellor's Budget Report

1.1 The Government announced its intentions within the July budget statement and set out the following policy:

*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.*

1.2 The Government has now published the criteria/guidance (Appendix 1) for pooling LGPS fund assets into up to six British Wealth Funds, each containing at least £25billion of scheme assets. Administering authorities are invited 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.

1.3 It will be for authorities to suggest how their pooling arrangements will be constituted and will operate. In developing proposals, authorities should have regard to each of the four criteria.

#### 2. What are the criteria?

2.1 The Government has invited proposals for asset pooling that will be assessed against the following criteria:

- a. **Asset pool(s) that achieve the benefits of scale** - administering authorities should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets.
- b. **Strong governance and decision making** - proposed governance structure for the pools should at the local level, provide authorities with assurance that their investments are being managed appropriately, and at the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.
- c. **Reduced costs and excellent value for money** - proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.
- d. **An improved capacity to invest in infrastructure** - proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class.

2.2 Alongside the guidance, the Government published a consultation (Appendix 2) on "backstop" legislation that would require those administering authorities that do not come forward with sufficiently ambitious proposals to pool their assets with others. The consultation contains two key proposals:

- a. radical reform of the LGPS investment regulations to enable LGPS funds to pool their investment,
- b. giving the Secretary of State a new power to intervene in the investment function of the LGPS fund if this investment approach has not had regard to the relevant regulations and guidance.

### 3. Expected Timeline

3.1 Initial proposals are required by **19 February 2016**, with refined and final proposals due by **15 July 2016**. Submissions should include a commitment to pooling and a description of the progress towards formalising the arrangements with other authorities. The expected timeline:

Consultation (including the backstop enforcement regulation issued).	25 November 2015
Consultation response from all stakeholders (12-week response period).	<b>19 February 2016</b>
Announcement in Chancellor's Budget Statement 2016 as to the delivery vehicles approved, and the level of savings identified.	Spring (March) 2016
New Investment Regulations published, including backstop legislation to mandate those Funds, who have not met the "DCLG reform criteria/guidance" re investment pooling.	March 2016
Refined and completed submissions from all stakeholders. Responses are required to identify each Fund's planned option to pool, outlining how savings are expected to be delivered from the implementation option chosen.	<b>15 July 2016</b>
Creation of asset pools (phased in over three years).	To April 2019

3.2 The East Sussex Pension Fund now needs to focus on which of our peers we will be pooling with and moving forward quickly on putting proposals together, given that responses need to be with the Government by February. The ESPF can choose whether to make individual or joint submissions, or both, for the 19 February 2016 submission.

### 4. East Sussex Pension Fund - Progress

4.1 A paper on the LGPS pooling was presented to the Pension Committee at its September – investment strategy day meeting, and presentation on LGPS investment pooling by Hyman's at its meeting of 24 November 2016. At its November meeting, the Committee requested that officers continue to consider investment pooling and collaboration options/proposals that will meet the forthcoming Government criteria's, for consideration at the next special meeting of the Pension Committee on 12 January 2016.

4.2 The fund (ESPF) already utilises collaborative arrangements extensively to ensure maintenance of the highest levels of performance whilst delivering value for money. The primary examples of this include the 'Orbis' business support and collaborative pension administration shared service (not including investment management) with Surrey County Council. There is also the on-going procurement of the investment consultancy services and actuarial/benefits consultancy contract utilising the LGPS National Frameworks. This is in addition to utilising the LGPS National Frameworks for specific legal service.

4.3 There will be significant work required to set up the new arrangements, and the expectation is that these should be in place within the next three years. Multi-asset pools ("MAPS") formed by regional and/or like-minded groups of funds can largely meet both the Government criteria and the needs of funds but may not be the best solution for all asset classes. Regional Collective Investment Vehicle (CIV) seem to be the only option being favoured by the Government and the Fund (ESPF) will continue to have informal discussions with neighbouring and similar size funds/councils to consider the possibility of setting up a Regional CIV.

4.4 Cost savings and governance will be key criteria in whether any proposal would be acceptable. This will involve looking at the forecast savings that we could make through participating/joining a pool, and also how the structure would be organised. Officers have been open to consideration of all options either currently available or requiring construction that would ensure the Fund retains strategic management of asset allocation, but, which may offer new opportunities. The driver being that an initial mover should be able to secure greater control than if the Fund is mandated to pool its assets through the 'backstop' DCLG regulations.

4.5 The Pension Committee will need to be aware that these changes are likely to involve significant changes in the investment of the fund, with no direct involvement in the selection of managers, and potentially some compromise with the detailed specification of mandates. However, with CIV option, the Fund will have a direct participation in the operation of the CIV. As well as offering costs savings, a well-structured pooled vehicle could offer the opportunity to share expertise and knowledge.

4.6 The DCLG reform criteria and as identified in the original Hymans Robertson report, the Chancellor's announcement makes it clear that Government is targeting LGPS investment fee savings of around £660m (*Passive management - £230m; illiquid assets - £240m; and transaction cost - £190m*). As such, the industry assumption is that a slice away from this fee base is the benchmark upon which any proposals involving asset pooling will be measured. It has been acknowledged that, as well as cost savings; the maintenance of existing overall investment performance is desired.

4.7 Officers have been participating in the Hymans investment pooling project to help deliver an authoritative, evidence based proposal, which will help the government to see the big picture and make the best decisions for the long term future of the Scheme.

## **5. Options for Pooling of Investment Assets**

5.1 It is evident from the DCLG Reform Criteria that the Government's preference is for greater scale in investment management through pooling of assets and other efficiencies.

5.2 The key factors that officers have looked to address in any option considered are that:

- asset allocation strategy must be retained at an individual Fund level;
- any new structure must be compatible with the Government's aims of ability to achieve economies of scale; improved governance and fee savings;
- the Fund should retain a pivotal role in the governance of any pooled structure chosen;
- any new structures should offer opportunities for savings, while retaining or preferably improving on the Fund's current performance;
- any solution provides additional resilience and capacity over and above current governance structures;
- the structure chosen must be sufficiently flexible to ensure assets are only transferred into any vehicle when/if it is efficient and effective to do so;
- any new structure must be scalable to ensure some level of future proofing;
- like-minded funds that will work in a collaborative and partnership way
- any new structure should be capable of complementing a bespoke investment strategy for scheme employers with common characteristics.

5.3 The 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.

5.4 The outline of options, vehicle and associated consideration for pooling, with a summary of current investment pooling initiative is attached as Appendix 4.

## **6. Conclusion**

6.1 This consultation is aimed at all funds within the Local Government Pension Scheme and seeks respondents' views on the proposals set out at paragraph 2 above. A response will be made to this new consultation and, amongst other things, to consult with the Pension Committee, Pension Board, SE7 Authorities, Hymans Robertson, Independent Adviser, etc., on the viability of these proposals in supporting the over-arching objectives of achieving sustainability and LGPS assets pooling criteria.

6.2 In the short time, it is important that the Fund 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.