SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **12 FEBRUARY 2016**

LEAD OFFICER: **SHEILA LITTLE, DIRECTOR OF FINANCE**

SUBJECT: **LGPS INVESTMENT REFORM: NATIONAL POOLING**

SUMMARY OF ISSUE:

At the summer Budget 2015, the Chancellor announced the intention to invite administering authorities to bring forward proposals for pooling Local Government Pension Scheme investments, to deliver significantly reduced costs while maintaining overall investment performance.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Committee approve and adopt the attached proposal to government reference the Border to Coast Pensions Partnership, shown in Annex 1 (not included within committee papers, to be issued before the meeting).

2 The Pension Fund Committee approve an initial £50,000 for consultancy and advisory costs.

REASON FOR RECOMMENDATIONS:

A national asset pooling proposal is invited by government by 19 February 2016.

DETAILS:

Background

1 Authorities are being asked to create up to national asset pools, each with at least £25bn of LGPS scheme assets in order to reduce investment costs and enable the authorities to develop more capacity and capability to become leaders in infrastructure investment. Authorities have been asked to consider who they will work with and how best to achieve the benefits of scale.

Chancellor's Intention

2 In the July 2015 Budget, the Chancellor announced the Government's intention to work with LGPS administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. Authorities are invited to submit proposals for pooling which the Government will assess against the criteria. The Chancellor has announced that the pools should take the form of up to six British Wealth Funds, each with

assets of at least £25bn, which are able to invest in infrastructure and drive local growth.

Deadline for response

3 Authorities are asked to submit their initial (brief and broad based) proposals based on four criteria (as set out in paragraphs 5 onwards) to the Government by 19 February 2016. Submissions should include a commitment to pooling and a brief description of their progress towards formalising their arrangements with other authorities. Authorities can choose whether to make individual or joint submissions, or both, at this first stage. Government will then feed back on the suitability of the initial submission.

4 Given the acceptability of the initial submission, the Government has stipulated that it requires refined, costed and complete submissions by 15 July 2016, which fully address the criteria in this document, and provide any further information that would be helpful in evaluating the proposals. At this second stage, the submissions should comprise:

a) for each pool, a joint proposal from participating authorities setting out the pooling arrangement in detail. For example, this may cover the governance structures, decision-making processes and implementation timetable; and
b) for each authority, an individual return detailing the authority's commitment to, and expectations of, the pool(s). This should include their profile of costs and savings, the transition profile for their assets, and the rationale for any assets they intend to hold outside of the pools in the long term.

Government criteria

5 The following criteria set out how administering authorities can deliver against the Government's expectations of pooling assets. It will be for authorities to suggest how their pooling arrangements will be constituted and will operate. In developing proposals, they should have regard to each of the four criteria, which are designed to be read in conjunction with the supporting guidance that follows. The submissions should describe:

A. Asset pools that achieve the benefits of scale

6 The 89 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported. Authorities should explain:

a) The size of their pool(s) once fully operational.
b) In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
c) The type of pool(s) they are participating in, including the legal structure if relevant.
d) How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.

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e) The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

B. Strong governance and decision making

7 The proposed governance structure for the pools should:

a) At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
b) 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.

8 Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability. Authorities should explain:

a) The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
b) The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
c) Decision making procedures at all stages of investment, and the rationale underpinning this.
d) The shared objectives for the pool(s), and any policies that are to be agreed between participants.
e) The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
f) How any environmental, social and corporate governance policies will be handled by the pool(s).
g) How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
h) How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
i) The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

C. Reduced costs and excellent value for money

9 In addition to the fees paid for investment, there are investment related costs within some asset structures that are difficult to ascertain and so are not reported in pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. 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.

10 Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

11 As part of their proposals, authorities should provide:

a) A fully transparent assessment of investment costs and fees as at 31 March 2013.
b) A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
c) A detailed estimate of savings over the next 15 years.
d) A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
e) A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

D. An improved capacity to invest in infrastructure

12 Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. 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. Authorities should explain:

a) The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
b) How they might develop or acquire the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than an existing fund, or "fund of funds" arrangements.
c) The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

Current pooling options being considered

13 The following pooling options have emerged and currently total more than the six pools that the Government intends to create.

14 **London CIV:** This is already established and has 32 of the 33 London Borough funds signed up to use it. Potential assets to pool total £24bn.

15 **Northern Powerhouse:** This is dominated by the large metropolitan funds including the Greater Manchester, Merseyside and West Yorkshire Pension Funds. This would create a pool of £42bn and would include a large proportion of internal management.

16 **Central:** This is dominated by the West Midlands Pension Fund (with internal management) plus seven other county funds. Part of this group recently completed a joint procurement for passive management. This would create a pool of around £35bn.

17 **Access Group:** Access stands for “A Collective of Central, Eastern and Southern Shires”. The group is on target to create a pool of around £25bn.

18 **South West Brunel Group:** These are regionally located and like-minded funds working together in the south west. This would create a pool of around £35bn.

19 **Lancashire/LPFA:** These are two very strong founder members but, to date, no further additional joining funds. The pool size is currently in the range of £10bn.

20. **Wales:** This is currently planning a Collective Investment Vehicle similar to London with assets of around £15bn.

21 **Border to Coast Pensions Partnership:** As discussed at the committee meeting of 13 November 2015, this is a geographically dispersed pool, including Surrey, East Riding and Cumbria, Lincolnshire, Warwickshire, North Yorkshire, South Yorkshire, Tyne and Wear, Durham and Northumberland. The pool size is currently £28bn with two other funds considering joining.

Cost implications

22 The creation of any pool will incur set up costs, along with a requirement for officer time and member support. It is too early to be more precise until the structural decisions about how the pool is created are agreed. It is recommended that the pension fund committee approve an initial £50,000 for consultancy and advisory costs. All costs will be distributed to all partnership funds on an equitable share of costs per fund.

Surrey’s Approach

23 As a founding member of the Border to Coast pool, the committee is asked to endorse the decisions to work with the group to achieve the best outcome of pooling for the Surrey Fund. Authorities are invited to submit a proposal (from their pooled group) to Government by 19 February 2016. The Border to Coast proposal will be shown as Annex 1 to this report.

CONSULTATION:

24 The Chairman of the Pension Fund Board has been consulted on the Border to Coast pooling initiative and has offered full support for the proposals and the document to be presented to government.

RISK MANAGEMENT AND IMPLICATIONS:

25 Risk related issues are contained within the report’s annex (the proposal to government).

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

26 Financial implications are contained within the cost base of the proposal to government.

DIRECTOR OF FINANCE COMMENTARY

27 Initial financial implications will be set out in Annex 1 and full details will be developed ahead of the detailed proposals required by 15 July 2016.

LEGAL IMPLICATIONS – MONITORING OFFICER

28 Legal implications will be discussed with the report that submits the Fund's final proposal later this year.

EQUALITIES AND DIVERSITY

29 An equality/diversity analysis will not be required as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

30 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT:

31 The following next steps are planned:

- Delivery of the Border to Coast initial proposal to Government by 19 February 2016.
- It is expected that Government will let asset pools know of the suitability (or otherwise) of their initial proposals.
- Developments will be discussed at future pension fund committee meetings.
- Delivery of the Border to Coast final proposal to Government by 15 July 2016
- Envisaged delivery of the implemented national pool by mid 2018.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Annex 1: Proposal to government

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Sources/background papers:
None

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