Suffolk County Council

Agenda Item 5

Suffolk Pension Fund Committee

Report Title:	Government's Pooling Proposals
Meeting Date:	27 January 2016
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Brief summary of report

1. This report provides an update on the work that has been undertaken to consider the Government's pooling requirements and looks at the best pooling option for Suffolk.

Action recommended

2. The Committee is asked to consider the report and to agree that the Suffolk Fund works with other like-minded funds within the ACCESS Group, to create a pool of a minimum size of £25bn that meets the Government's criteria.

Reason for recommendation

3. The Government requires all Local Government Pension Funds to respond by 19 February 2016, setting out how they intend to pool their assets in the future and who they plan to form a pool with.

Alternative options

4. The Committee could decide to investigate pooling with an alternative grouping other than the ACCESS Group.

Main body of report

5. The Pension Fund Committee meeting on 30 November 2015 received a presentation on the government's Pooling Criteria and the work that was underway to establish pooling options for Suffolk.
6. The purpose of this report is to remind the Committee of the Government's proposals, to receive the outcomes of the joint project with Hymans Robertson and to consider the pooling options for Suffolk.

Reminder of the Government's Pooling Criteria (taken directly from the announcement document)

7. In the July Budget 2015, the Chancellor announced the Government's intention to work with Local Government Pension Scheme (the Scheme) 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.

8. The following criteria set out how administering authorities can deliver against the Government's expectations of pooling assets.

9. 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:

10. **A. Asset pool(s) that achieve the benefits of scale:** 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.

    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.

11. **B. Strong governance and decision making:** 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.

12. 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.

13. **C. Reduced costs and excellent value for money:** In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so are rarely reported in most 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.

14. 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.

15. 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.

16. **D. An improved capacity to invest in infrastructure:** 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.

17. Authorities are asked to submit their initial proposals to the Government by 19 February 2016. Submissions should include a commitment to pooling and a 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.

18. Refined and completed submissions are expected 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.

Outcome of Project Pool

19. The purpose of this report is to provide government with a joined up response from local authorities who run LGPS funds, setting out proposals which are sufficiently ambitious and will achieve government objectives in a way that also meets the needs of those who administer and manage the LGPS on behalf of the 4.6 million scheme members. The government has required that the assets should be formed into up to six pools with a minimum size of £25bn.

20. This report has been prepared by local authority officers from participating funds who have collaborated under the banner of Project POOL, supported by Hymans Robertson. Project POOL set out with three goals;

a) to produce an evidence based and objective analysis of pooling options

b) to enable LGPS stakeholders to gather round one or a small number of options which satisfy the Government's criteria

c) to form a basis of discussion between the LGPS and Government on the best way forward

21. The full report, along with a free standing summary report is due to be published week commencing 18 January. A copy of the summary report will be sent to committee members as soon as it is published.

22. The purpose of Project POOL was to identify the most effective way for LGPS funds to form larger investment pools to achieve cost savings and other scale benefits within the constraints set out by the government, evidencing the conclusions with objective data and analysis.

23. The local authorities participating in the project have come to a strong consensus on the preferred approach – **Multi-asset Pools (MAPs) formed by groups of regional or like-minded funds**. On day one, a number of MAPs may have the option of "in-house" management as well as external investment management while others will only offer external management. These MAPs should be complemented by a small number of additional investment arrangements accessible to all of the pools for asset types where LGPS-wide collaboration may deliver greater benefits (e.g.an infrastructure investment platform or a national procurement of passive investment managers). We refer to this pooling model as "**MAP Plus**".

24. Discussions between funds to create MAPs along the lines set out in this report are already in progress. Those discussions are informed by the work of Project POOL between September and December 2015. There is additional analysis in the detailed work of the Project work-streams that will also be helpful as these plans are taken forward. It is anticipated that this summary report and the more detailed report published alongside it will be useful to all local authorities and elected members involved in the LGPS and to government, in the period between now and the deadlines for pooling proposals in July 2016, and in the implementation phase that will follow.

25. Options for Suffolk

26. Suffolk, along with several other Funds, decided to wait until the Project Pool work was complete in order to establish the best "How we should pool" option, before considering who we should pool with.

27. Appendix 1 includes a draft statement of what Suffolk would like to see in a pool that it participated in. This was drawn up in consultation with the Vice Chairman of the Committee. This has been used to determine the best option for Suffolk.

28. The following pooling options have emerged and currently total more than the six pools that the Government intend to create. This will either mean that the Government will alter its criteria, or that proposed pools will be rejected if the size threshold is not met.

29. **London CIV** – This is already established and has 31 of the 33 London Borough Funds signed up to use it. Potential assets to pool total £24bn.

30. **M62** – This is dominated by some very large metropolitan funds including Greater Manchester, Merseyside and West Yorkshire Pension Funds. This would create a pool of £50 – 60bn and would include a large proportion of internal management.

31. **Central** – One large Fund (with internal management) plus 7 other county funds. This group recently completed a joint procurement for passive management. Pool size in region of £35bn.

32. **Access** – Grouping of County based Funds in the South and East, committed to collaborative, structured, democratic and evidence based decisions. Pool size in range of £22 – 38bn.

33. **South West** – Like minded funds working together in the South West with a strong Environmental, Social and Governance focus. Pool size £20 – 24bn.

34. **Border to Coast** – A geographically dispersed pool including Surrey, East Riding and Cumbria. Pool size in range of £13 – 17 bn.

35. **Lancashire / LPFA** – Two very strong founder members, but to date no further additional joining funds. Pool size currently in the range of £12 – 16bn.

36. **Wales** – Currently planning a Collective Investment Vehicle similar to London with assets of £15bn.

37. The pools that currently do not meet the £25bn threshold are looking for others to join them.

38. For Suffolk, officers have met with the other Funds linked to the ACCESS group and have worked on some principles for the pool. A draft of these is attached at Appendix 2. These have a close synergy to Suffolk's wish list for pooling (Appendix 1). The funds are currently all externally managed and, from an initial assessment of data, over two thirds of the funds are covered by 12 existing investment managers.

39. ACCESS stands for A Collection of Central, Eastern and Southern Shires – a working title.

40. The following Funds have indicated that they intend to recommend to their committees to pool through the ACCESS Group:

    i) Norfolk
    ii) Cambridgeshire
    iii) Essex
    iv) Suffolk
    v) Northamptonshire
    vi) Kent
    vii) West Sussex
    viii) Isle of Wight

41. If these funds do all agree to pool, then this would create a pool of about £22bn. Many of these funds were also fully involved in the work of Project pool, and included providing work stream leaders for chapters of the report including the following asset classes - Active Equities, Passive management, Fixed

Income, and Property, as well as the chapter covering the options for regional pools.

42. In addition to the eight funds listed above, the following funds have been involved in the initial meetings and are yet to decide who they intend to pool with. These include:

    i) East Sussex

    ii) Hampshire

    iii) Hertfordshire

    iv) Bedfordshire

43. It is considered highly likely that at least one of these funds will pool with the ACCESS Group, therefore achieving the £25bn target.

44. The creation of any pool is likely to incur significant set up costs, along with a requirement for significant officer time and member support. Initial estimates of the set up costs are likely to be in the region of £300k per fund, but it is too early to be more precise until we know how many funds are involved and some of the structural decisions about how the pool is created are agreed. This is based on an equal share of costs per fund.

45. The Committee is asked to consider the options for pooling of the Suffolk Fund, and is recommended to work with the ACCESS group to achieve the best outcome of pooling for the Suffolk Fund.

Sources of further information

a) Project Pool Full report and Summary document – the later will be emailed to Committee members once it has been published.

b) DCLG publication - Local Government Pension Scheme: Investment Reform Criteria and Guidance – November 2015

Appendix 1

Suffolk's wish list for Pooling

We wish to pool with like-minded funds to achieve the scale and ambition required of us by the Government's pooling criteria.

We want to be a shareholder and have equal voting rights in the organisation that oversees the investment of the Suffolk Pension Fund.

We want the asset allocation decision making to be delegated as far as possible to the Pension Fund Committee, with the choice of manager being the responsibility of the pool.

We understand that some compromises will have to be taken along the way, but want to ensure that the investment performance of the Fund is not detrimentally affected.

We sign up to the following values in working with partners….

Cultural

- To work in a collaborative and partnership way
- To be inclusive and not dominant
- To recognise and draw on the strengths and talent of existing resources
- To share knowledge and expertise
- To listen and be constructive in discussions
- To make pragmatic decisions as long as they are not materially detrimental to own fund(format)
- To commit to openness and transparency to enable evidenced based decisions
- To use evidence to influence and embrace change

Practical

- Will have an investment strategy that can be aligned to sub funds structure and transition plans
- Will have complementary investment beliefs
- Will be willing to pool as we evidence and identify the road map to achieve real savings without long term detriment to performance
- Will operate within the governance that will be put in place to make decisions on sub funds and fund managers
- Will have delegations that will allow the governance to work