

Decision Maker: Pensions Investment Sub-Committee

Date: 11 February 2016

Decision Type: Non-Urgent Non-Executive Non-Key

Title: **POOLING OPTIONS**

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Chief Officer: Director of Finance

Ward: All

1. Reason for report

This report provides an update on Local Government pension scheme consultation relating to "Local Government Pension Scheme: Investment Reform Criteria and Guidance" and investment pooling options.

2. **RECOMMENDATIONS**

2.1 **The Sub-Committee is asked to:**

- (a) Consider the key principles in considering a pooling arrangement (see 3.2);
- (b) Comment on the pooling options currently being explored;
- (c) Agree that the Director of Finance, in consultation with the Chairman and Vice Chairman submits the formal consultation response which will incorporate views expressed at this meeting;
- (d) Note that the final consultation response will be emailed separately to all Members of the Pensions Investment Sub-Committee, once available.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations for the purpose of providing pension benefits for its employees. The LGPS (Management and Investment of Funds) Regulations 2009 allow local authorities to use all the established categories of investments (e.g. equities, bonds, property etc) and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.
 2. BBB Priority: Excellent Council.
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Financial

1. Cost of proposal: Estimated cost Set up costs (see section 5)
 2. Ongoing costs: Recurring cost. Total administration costs estimated at £3.3m (includes fund manager/actuary/advisor fees, Liberata charge and officer time)
 3. Budget head/performance centre: Pension Fund
 4. Total current budget for this head: £36.6m expenditure (pensions, lump sums, etc); £41.5m income (contributions, investment income, etc); £732.0m total fund market value at 31st December 2015)
 5. Source of funding: Contributions to Pension Fund
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Staff

1. Number of staff (current and additional): 0.4 FTE
 2. If from existing staff resources, number of staff hours: c 14 hours per week
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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations
 2. Call-in: Call-in is not applicable.
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 6,150 current employees; 5,073 pensioners; 5,223 deferred pensioners as at 31st December 2015
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Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.
2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

3.1 Consultation Document - Pooling of Investments

- 3.1.1 The Chancellor's Summer Budget announced on 8th July 2015 included the following message:

"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."

This was followed by a speech by the Chancellor at the Conservative Party Conference as follows *"we are going to find new ways to fund British infrastructure that drives our productivity ...At the moment we have 89 local government pension funds with 89 sets of fees and costs. It's expensive, and they invest little or nothing in our infrastructure. So I can tell you today we are going to work with councils to create half a dozen British wealth funds spread across the country"*.

- 3.1.2 For London, the Treasury appear to see this approach as building on the work already done by the London CIV (see 3.6.2).
- 3.1.3 Since the announcement the Government have indicated that they wish to see all assets (including equities and bonds) pooled within three years with more time required for unlisted assets. The expectation is that the 89 Local Government pension Scheme Administering Authorities (assets over £190bn) will pool scheme assets into investment pools. The Government appear open minded, at this stage, about whether the pools would be actively or passively managed or whether there would be a mix of both.
- 3.1.4 Department of Communities and Local Government (DCLG) have produced a criteria for pooling which is not subject to consultation shown below. Their commentary is shown in italics:

- (a) Asset pool(s) that achieve benefits of scale

The 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 of benefits that these arrangements are expected to deliver and explain how these benefits will be realised, measured and reported.

- (b) Strong Governance and Decision Making

At a 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 interest of their members.

(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 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 and Capability 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 the asset class.

- 3.1.5 The Chancellor has previously referred to pools taking the form of up to 6 British Wealth Funds, each with assets of at least £25bn. The pools being developed (see 3.4) are different in number and value and it is not clear whether the limit of 6 funds and minimum value of £25bn will become a mandatory requirement.
- 3.1.6 Based on the above proposals the Council will still retain decisions on Investment Strategy and asset allocation, with the help of their advisers, and funding responsibilities for current and past deficit contributions would remain.
- 3.1.7 The Government accept that a limited number of investments can be outside the pool e.g. direct property investments.
- 3.1.8 Administering authorities are asked to submit their initial proposals to the Government by 19th February 2016 and the submissions are expected to include a commitment to pooling and details of progress towards formalising their arrangements with other Pension Funds. Administering authorities can choose whether to make individual or joint submissions, or both, at this first stage. Funds that do not join a specific pool will have to present their own individual submissions to government to explain they are still considering.
- 3.1.9 Refined and completed submissions are expected by 15th July 2016, which fully meet the criteria, and provide any further information that would be helpful in evaluating the proposals. Detailed evidence will be required to be submitted – a major piece of work.
- 3.1.10 Any final pooling arrangement will be expected to “go live” by April 2018.
- 3.1.11 The Government will “work” with local authorities who do not develop sufficiently ambitious proposals and will also consider “backstop” legislation where not satisfied (could result in intervention in investment function).
- 3.1.12 The Government require the new pools to control procurement in order to achieve larger savings in the longer term.

3.2 Key Principles in Considering a Pooling Arrangement

3.2.1 In considering a pool, I suggest the following draft key principles in selecting a final pooling arrangement:

- Similar size of funds
- No single dominant Fund
- Every fund in the pool will have an equal voice in the Pool
- Manageable number for Governance
- Is the investment approach and philosophy similar
- Dependency on internal and external management (Bromley has a low dependency on internal management)
- Set up costs, running costs and savings in fund manager and other fees
- Assists trustees in fiduciary duty to act in the best interest of their members, as well as acting prudently, responsibly and honestly.

3.2.2 Members are requested to comment on the draft principles identified.

3.3 Saving in Management Fees and Other costs

3.3.1 The Council's current management fees are £2.8m which equates to an average of 0.3885% across the portfolio. A reduction of 5 base points in fees would save £367k per annum. The fees are based on a total portfolio value of £732m as at 31/12/15.

3.3.2 The Council has 3 fund managers for Global Equities (Blackrock, MFS and Baillie Gifford), 2 fund managers for Diversified Growth Fund (Standard Life and Baillie Gifford) and 2 fund managers for fixed income (Baillie Gifford and Fidelity). A total of 5 different fund management organisations.

3.3.3 Project Pool was established in September 2014 to provide proposals that will meet criteria and parameters specified by Government in relation to scale, cost savings, governance and access to infrastructure. Project Pool commissioned by 24 councils administering LGPS funds, 13 other pension funds, 40 fund managers and consultancy Hymans Robertson reported on potential savings of at least £190m in the longer term (timeframe of say 10 years) nationally through pooling local government pension funds. The report said that savings would not be immediate to reflect pension funds needing to "run off" existing contracts with current investment management arrangements. Any transition of assets will require costs and resources to deliver such change and there will be costs in the shorter term before savings become realised in the medium term. To provide some context there are 89 LGPS funds in England and Wales with a market value of £189bn at 31/3/15. The savings identified assume ongoing increases in fund values in the longer term and associated savings. A previous report by PWC indicated that the pooling of investments could save up to £600m per year which has been quoted in government circles. The only conclusion is that there are potential significant savings which are difficult to quantify.

3.4 Formation of Pooled Funds

3.4.1 There are a number of collaborations that are emerging. The latest national picture, with regard to pooling appears as follows (source: LGPS Pooling Vehicles as reported by Local Government Chronicle (29/1/16)):

Border to Coast – potential value £32bn

Warwickshire, Lincolnshire, East Riding of Yorkshire, North Yorkshire, Cumbria and Surrey

Northern Powerhouse – potential value £40bn

Greater Manchester, West Yorkshire and Merseyside

Midlands – potential value £35bn

Cheshire, Derbyshire, Nottinghamshire, Shropshire, Staffordshire, West Midlands Integrated Transport Authority, West Midlands and Worcestershire

South West CIV – potential value of £20bn

Avon, Cornwall, Devon, Dorset, Gloucestershire, Somerset, Wiltshire and the Environment Agency (and potentially Oxfordshire)

ACCESS – potential value of £38bn

Kent, Northamptonshire, Cambridgeshire, Norfolk, Suffolk, Essex, West Sussex and Isle of Wight

London CIV – potential value of £24bn

Currently only London Boroughs

Lancashire and London Pensions Partnership – potential value of £10bn

Lancashire and London Pension Fund Authority

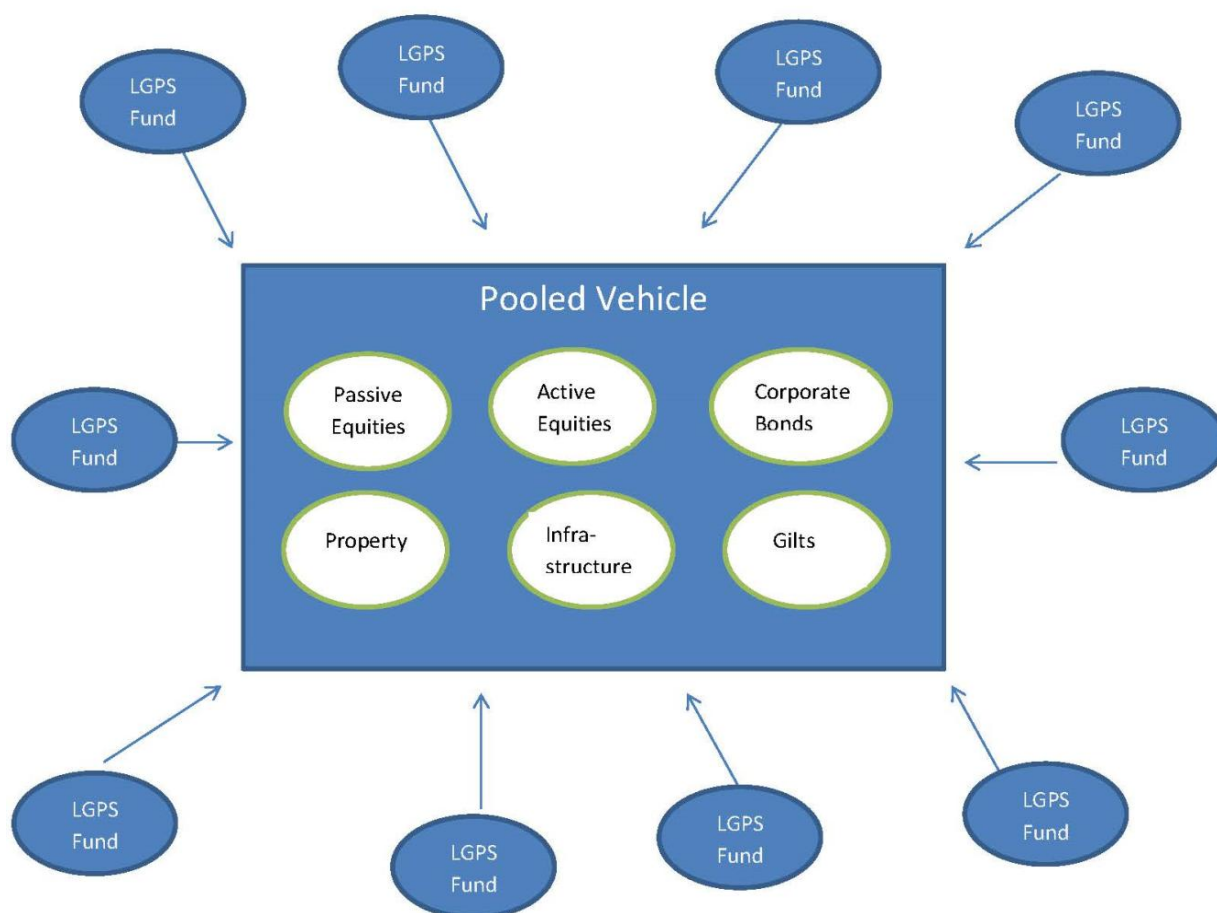
Greater Manchester and LPFA infrastructure vehicle - £500m

3.4.2 In addition, the pooling of the Welsh funds would have a potential value of £15bn. Not all of the pools above are being formed along geographical lines and having similarity of investment strategies appears to be a main determinant for pools that are not regionally based.

3.4.3 The two pools currently being explored further at Bromley are the ACCESS pool and the London CIV. ACCESS is “A Collaboration of Central, Eastern and Southern Shires”. Not all funds have decided on how they will proceed although most have narrowed down their approach to a couple of pools and deciding between them.

3.5 Structure of Pooled Vehicle

3.5.1 The diagram below illustrates the multi-asset classes of a pooled investment vehicle. Any pooled vehicle is likely to be subject to Financial Conduct Authority regulation.



3.5.2 An example of a pooled arrangement is through an Authorised Contractual Scheme (ACS) as shown in Appendix 1 and represents the current arrangement for the London CIV. ACS is required to be FCA regulated and would take about 18 months to establish. The cost of establishing and running a pool would need to be met although in the medium to longer term such costs would be more than offset by savings in investment costs through economies of scale. The ACS operator would be governed by a board of the LGPS fund Chairmen who will determine policies and parameters of the ACS and monitor performance. The operator would choose investment managers with the specific LGPS funds providing their asset allocations to the Operator for Implementation. This is a fundamental change to how LGPS funds are managed. The London CIV uses an ACS model (see Appendix 1). The ACS structure is a favourable tax vehicle for pension funds to enable recovery avoiding "tax drag" on overseas investment returns.

- 3.5.3 The Government has no fixed ideas on the type of structures to be chosen but is looking for funds to choose structures that are robust and make substantial cost savings whilst ensuring good investment performance.
- 3.5.4 There may be other alternative arrangements that are being explored through the pools being formed which may include a joint committee arrangement model. These options are expected to be concluded after the initial response to consultation.
- 3.5.5 From a Pensions Investment Sub-Committee perspective the only key decision making that would change is manager selection. The Committee determine the investment strategy and asset allocation, as at present, and the pool will manage the investments of the Fund, and the manager selection using the asset allocation of the Committee. The pool therefore will be responsible for the manager choice and will be accountable to the Fund for poor investment decisions. The Pool will report to the fund on the performance of its investments, rather than the manager presentation meetings currently held.

3.6 Options for the Council

3.6.1 ACCESS

3.6.1.1 Although some pools have made more progress towards a pooling structure and governance arrangements, ACCESS is at an earlier stage of formation. It includes authorities which appear similar to Bromley in investment approach. The value of funds range from £0.5bn to £5.1bn (average value of £2.69bn). If Bromley joined ACCESS it would have the second lowest fund value but there would not be a single dominant fund and there are expected to be up to 14 authorities that may join ACCESS. There will be set up costs, depending on governance structure adopted etc. which could range between £2 million and £3 million and any joining authority will be required to contribute towards such costs. The ACCESS pool will be established on a multi-asset basis to maximise the potential fee savings. It is expected to adopt a One Member One Vote approach and it is not clear how any set up costs will be distributed (as proportion of fund value or proportionate to number of members?). ACCESS members appear to have some strong commonality with the Bromley Fund with heavy reliance on external fund managers and a similar approach with investment strategy. Further examination is required and the Director of Finance and Chairman of Pensions investment Sub-Committee will progress with exploring the benefits of joining ACCESS on behalf of Members.

3.6.1.2 ACCESS is keen to explore LGPS-wide collaboration for the creation of a national infrastructure investment platform, to share best practice and manage transitions.

3.6.1.3 The objectives of ACCESS are shown below:

- Help participating authorities to execute their fiduciary responsibilities to LGPS stakeholders, including scheme members and employers, as economically as possible.
- Enable participating authorities to achieve the benefits of pooling investments while preserving the best aspects of what is currently done locally and the desired level of local decision making and control;
- Provide a range of asset types necessary to enable those participating authorities to execute their locally decided investment strategies as far as possible.

To achieve these objectives the ACCESS pool has determined the following guiding principles

- The participating authorities will work collaboratively;
- All participating authorities will have an equal voice in governance;
- Decision making will be objective and evidenced based;
- The pool will use professional resources and risk management processes appropriate to the responsibilities of managing one of the biggest pools of pension assets in the UK;
- The pool will avoid unnecessary complexity in its approach;
- The pool will evolve its approach to meet the changing needs and objectives of participating funds;
- The pool will be open to innovation that will enable it to better service the pool's participants;
- The pool will be established to run economically, avoiding unnecessary cost;
- The pool's costs will be shared equitably.

3.6.2 London CIV

3.6.2.1 The London CIV has taken 2 years to implement and is now established and operational. The London CIV is fully authorised by FCA as an alternative Investment Fund Manager with permission to operate a UK based ACS Fund. The City of London and 30 London Boroughs have joined and another London borough is expected to join shortly. The first sub fund has opened, an active global equities fund, and three authorities are the initial seed investors with £500m of assets transferred in on 2nd December 2015. A further eight sub-funds, comprising a mix of active and passive equity funds are being opened over the next few months. By the end of 2016 it is currently estimated to deliver £3m savings in fund fees from £6bn of assets. The London CIV ambition is to deliver fund management savings of £30m per annum by 2020. The London CIV is fully authorised to operate in-house fund management and this option is expected to be explored at a later stage to determine whether it could deliver additional efficiencies and performance.

3.6.2.2 The guiding principles and objectives adopted by the London CIV are:

- Investment in the ACS should be voluntary, both entry and withdrawal;
- Boroughs choose which asset classes to invest into, and how much;
- Borough shareholders should have sufficient oversight over the ACS operator;
- Investing authorities will take a shareholding interest in the operator;
- Shareholders will have membership of the Pensions Joint Committee;

- ACS Operator will provide regular information to participating boroughs;
- ACS will not increase the overall investment risk faced by the boroughs;
- Overall control of pension funds stay at individual local authority level;
- A tax transparent structure assists in tax reclaims;
- Achieve reductions in custody and fund manager fees from greater buying power and reduce procurement costs;
- Achieve governance/shared training/knowledge benefits;
- Provide access to “alternative” investments.

3.6.2.3 Local authorities have had to make individual contributions of £75k to date and will be expected to contribute a further £25k in 2016/17. Contributions to date have also covered the set up cost of the London CIV which would need to be incurred in joining any other pooled vehicle. In the future the London CIV is expected to recover its costs through a fee to each sub-fund ranging from 0.005% for passive funds to 0.025% for the active funds. Every participating borough is expected to have the opportunity to migrate to the CIV by March 2017.

3.6.2.4 Representing the borough level, a Sectoral Joint Committee (Chairmen of individual Pension Committees) has been established under the governing arrangements of London Councils. This effectively provides One Member One Vote. There is a separate officer committee to support the member committee led by a few borough treasurers and includes pension fund managers from across the boroughs. London CIV have reported negotiating fee reductions of up to 50%.

3.7 Next Steps

- 3.7.1 In order to progress with determining the best ‘pool’ to join, the Director of Finance is liaising with the Chairman and Vice Chairman of Pensions Investment Sub Committee and Resources Portfolio Holder which will also assist in informing the consultation response to Government.
- 3.7.2 Meetings are being arranged separately with LB Wandsworth and Kent County Council on their experience relating to the London CIV and progress with ACCESS respectively.
- 3.7.3 Any decision to join a ‘pool’ will be reported to Pensions Investment Sub Committee. The ultimate decision may require the approval of full council as part of any final proposals to be submitted to Government in July.
- 3.7.4 Members have previously expressed concerns about the risks of pooled funds evolving towards external control of the asset allocation strategy. The current proposals continue to allow the asset allocation control to be retained by the administering authorities who would implement the strategy using the pooled fund operator to enable reductions in management fees through economies of scale, whilst retaining the choice of fund managers in the short term.

3.8 Conclusion

- 3.8.1 There are potential benefits from pooling if it delivers cost savings, by providing scale, increased resilience, knowledge sharing and robust governance and decision making arrangements without compromising on the Council's "sovereignty". Under the current proposals individual pension funds will retain their separate identities and local accountability. Pooling may provide access to opportunities not available to individual funds.
- 3.8.2 There are some asset types where greater benefits would be gained through LGPS pooling. In particular this would apply to infrastructure.
- 3.8.3 Any net savings from pooling will be realised in the medium and longer term, particularly from investment fees, but there will be initial costs relating to the setting up of a pooling arrangement and associated transition costs.
- 3.8.4. Both the option of the London CIV and ACCESS are being considered further, prior to the consultation initial response due on 19th February 2016.

4. POLICY IMPLICATIONS

- 4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations, for the purpose of providing pension benefits for its employees. The investment regulations (LGPS Management and Investment of Funds Regulations 2009) allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

5. FINANCIAL IMPLICATIONS

- 5.1 There will be set up costs relating to the ACCESS pool, depending on governance structure adopted which could range between £2 million and £3 million and any joining authority will be required to contribute towards such costs. The ACCESS pool will be established on a multi-asset basis to maximise the potential fee savings. It is not clear how any set up costs will be distributed (as proportion of fund value or proportionate to number of members?) and such set up costs may be higher than joining the London CIV.
- 5.2 For the London CIV, local authorities have had to make individual contributions of £75k to date and will be expected to contribute a further £25k in 2016/17. Contributions to date have also covered the set up cost of the London CIV which would need to be incurred in joining any other pooled vehicle.
- 5.3 In the longer term any pooled investment vehicles should be able to recover its costs through fees to each sub fund. Specific financial arrangements and potential future savings cannot be quantified at this stage.

6. PERSONNEL IMPLICATIONS

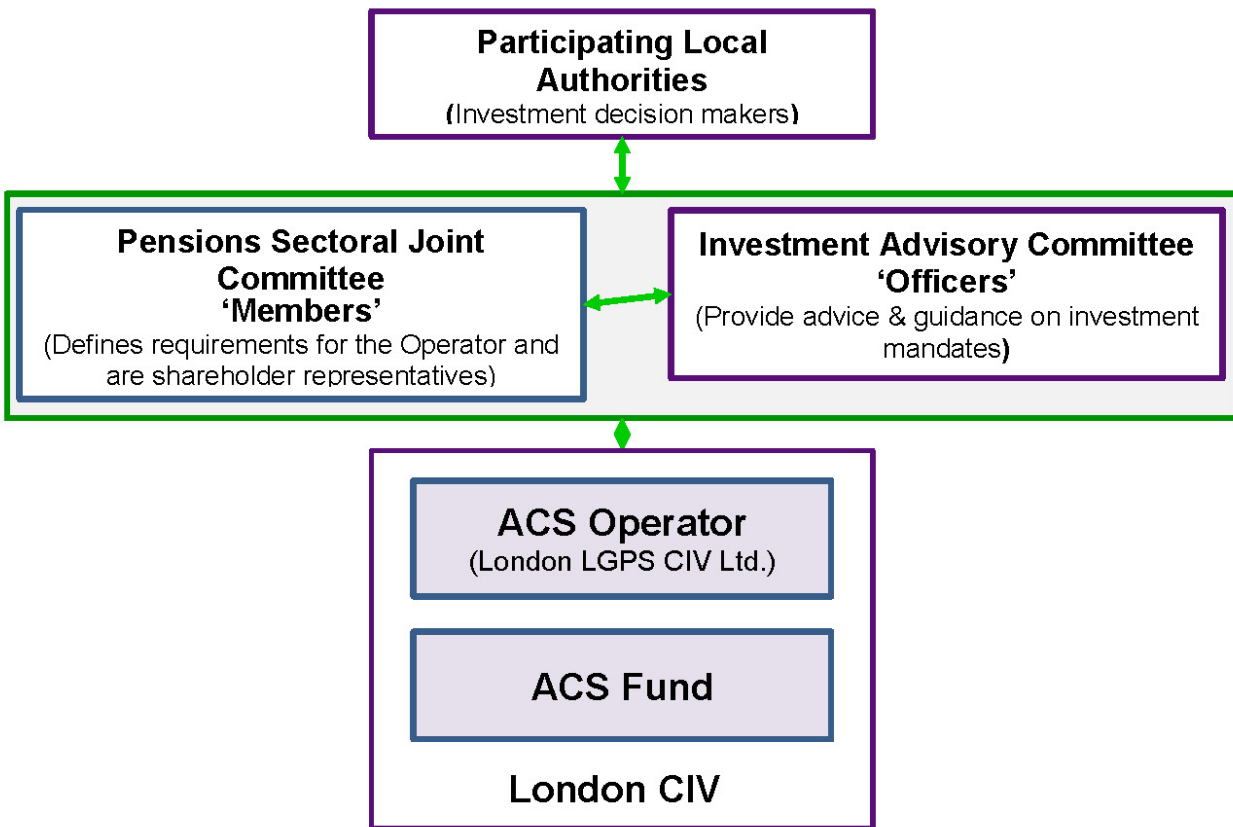
- 6.1 None arising directly from this report.

7. LEGAL IMPLICATIONS

- 7.1 The statutory provisions relating to the administration of the LGPS are contained in the Local Government Pension Scheme Regulations 2013. The investment regulations, LGPS (Management and Investment of Funds) Regulations 2009, set out the parameters for the investment of pension fund monies.
- 7.2 The Government will “work” with local authorities who do not develop sufficiently ambitious proposals and will also consider “backstop” legislation where not satisfied (could result in intervention in investment function).

Background Documents: (Access via Contact Officer)	Members Pension Seminar, 11 th January 2016 General Update, Pensions Investment Sub-Committee, 23 rd September 2015
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London CIV governance diagram



London CIV organisation chart

