Report No.
FSD19032

London Borough of Bromley

PART 1 – PUBLIC

Decision Maker:	**PENSIONS INVESTMENT SUB-COMMITTEE**
Date:	**5th March 2019**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**LBB RESPONSE TO DRAFT LGPS STATUTORY GUIDANCE ON ASSET POOLING CONSULTATION**
Contact Officer:	Jo-Anne Chang-Rogers, Principal Accountant Tel: 020 8313 4292 E-mail: jo-anne.chang-rogers@bromley.gov.uk
Chief Officer:	Director of Finance
Ward:	All

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1. Reason for report

1.1 This report asks Members to consider the response to the Government's consultation document "Local Government Pension Scheme – Statutory Guidance on Asset Pooling" and to delegate the finalisation of this Council's response to the consultation document to the Pension Investment Sub-Committee Chairman and the Director of Finance. The draft statutory guidance was issued on 3 January 2019 and the 12 week consultation period closes on 28 March 2019.

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2. RECOMMENDATIONS

2.1 The Pensions Investment Sub-Committee is asked to:

(a) Consider the response to the consultation document "Local Government Pension Scheme – Statutory Guidance on Asset Pooling, attached as Appendix 1.

(b) Note the consultation document "Local Government Pension Scheme – Statutory Guidance on Asset Pooling, attached as Appendix 2.

(c) Agree that the Director of Finance, in consultation with the 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.

Impact on Vulnerable Adults and Children

1. Summary of Impact: Not Applicable

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 investment regulations (The LGPS (Management and Investment of Funds) Regulations 2016) 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.

Financial

1. Total cost of proposal: No additional cost

2. Ongoing costs Not Applicable:

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £40.7m expenditure (pensions, lump sums, etc); £52.5m income (contributions, investment income, etc); £963.7m total fund market value at 31st December 2018)

5. Source of funding: Contributions to Pension Fund

Personnel

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 2013, LGPS (Management and Investment of Funds) Regulations 2016.

2. Call-in: Not Applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 6,316 current employees; 5,328 pensioners; 5,755 deferred pensioners as at 31st January 2019

Ward Councillor Views

1. Have Ward Councillors been asked for comments? Not Applicable

2. Summary of Ward Councillors comments: Not Applicable

3. COMMENTARY

3.1 **Responses to the draft Statutory Guidance issued for consultation**

Members were briefed at the Special Pensions Investment Sub-Committee meeting on 14th January 2019, that the draft "Local Government Pension Scheme – Statutory Guidance on Asset Pooling" had been issued by MHCLG on 3 January 2019. The consultation will remain open for 12 weeks and will close on 28 March 2019. The terms of the consultation are that responses should:

- Be sent to LGPensions@communities.gov.uk.
- indicate if the response is an individual response or on behalf of an organisation
- indicate which section of the guidance is being commented on.

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3.2 The MCHLG guidance will replace the section at pages 7 to 8 of Part 2 of the Guidance for Preparing and Maintaining an Investment Strategy, issued in September 2016 and revised in July 2017, which deals with regulation 7(2)(d) of the 2016 Regulations. It will also replace Local Government Pension Scheme: Investment Reform Criteria and Guidance, issued in November 2015.

3.3 Overall this guidance is statutory, as indicated by the title. However, this Statutory Guidance will require different levels of adherence. This draft guidance uses 'should' or 'may' or 'are expected'. The statutory nature of some of the guidance is indicated by the sections where pool members or pool companies '*are required'* or '*must'* comply.

3.4 A draft response to the consultation document is attached in Appendix One. The consultation document is attached as Appendix Two

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 (The LGPS (Management and Investment of Funds) Regulations 2016) 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 no additional costs arising from the consultation response.

6. LEGAL IMPLICATIONS

6.1 The statutory provisions relating to the administration of the Local Government Pension Scheme are contained in the Local Government Pension Scheme (LGPS) Regulations 2013. The investment regulations (The LGPS (Management and Investment of Funds) Regulations 2016) set out the parameters for the investment of Pension Fund monies.

6.2 As set out in paragraph 3.3, the draft guidance includes some aspects which reflect legislation or regulation. Compliance with these is mandatory. Other aspects of the statutory guidance must be complied with, unless there are compelling reasons not to do so, which must be considered against the overall government framework for the LGPF. Finally some elements will be general guidance which we must consider and should comply with, unless we have good reason not to do so.

Non-Applicable Sections:	
Background Documents:	Local Government Pension Scheme – Statutory Guidance

(Access via Contact Officer)	on Asset Pooling

Appendix One

London Borough of Bromley Response to		
Draft - Local Government Pension Scheme – Statutory Guidance on Asset Pooling		
Section/Paragraph Reference	**Extract of Consultation document text**	**LBB Response**
Foreword	" …and significant annual savings have already been delivered, with the pools forecasting savings of up to £2bn by 2033…..	The Council has in previous consultations on pooling raised concerns about the opportunities to work with other councils to reduce management fees and the risk of any pooled savings being offset by significant organisational costs of the pools. The Council will always welcome measures to reduce costs which are not detrimental to fund performance. We would welcome the sharing of evidence of the savings identified and any comparison data between pools. It is important to consider whether there were opportunities to deliver savings without the use of a costly pool. After allowing for the transitional costs and annual service fees/development charge for being part of the London CIV it would take up to 9 years to fully recover the costs arising from the transfer of 40% of the Council's pension fund investment. We would welcome the sharing of evidence of the savings identified and any comparison data between pools.
Section 3 Structure and scale	3.1 All administering authorities must pool their assets in order to deliver the benefits of scale and collaboration. These include: • reduced investment costs without affecting gross risk-adjusted returns	This Council recognises that it must comply with government requirements relating to being part of a 'pool'. We welcome the benefits of scale and collaboration. However, we have a fiduciary duty to pension fund members and accountability to the council tax payer. We do not wish

London Borough of Bromley Response to		
Draft - Local Government Pension Scheme – Statutory Guidance on Asset Pooling		
Section/Paragraph Reference	**Extract of Consultation document text**	**LBB Response**
	• reduced costs for services such as custody, and for procurement • strengthened governance and stewardship and dissemination of good practice • greater investment management capacity and capability in the pool companies, including in private markets • increased transparency on total investment management costs • diversification of risk through providing access to a wider range of asset classes, including infrastructure investments	to be compelled to pool assets, where it is at the expense of higher performance. We have a track record of success in investment decisions and we would have possibly had different procurement choices which could have had a detrimental impact on the performance achieve. We have always responded on the basis that being part of a pool should be on a voluntary basis, recognizing that a pool may provide benefits to some administering authorities. Transition costs should be included in savings calculations. To our knowledge transition costs have not been collected (from us) or monitored. Therefore reported projected savings may not be as large as anticipated or reported. Transferring assets into a pool creates taxation costs and the impact of transitional costs should not be underestimated.
Section 3 Structure and scale	*Regular review of active and passive management* 3.6 Pool members, working with the pool company, should regularly review the balance between active and passive management in the light of performance net of total costs. They should consider moving from active to passive management where active management has not generated better net performance over a reasonable period. Pool members should also seek to ensure	This council favours regular review. However, this draft guidance seems to favour passive management. This council has selected asset managers who invest over the long term. The performance of the LB Bromley Fund is demonstrated by winning the LGPS Investment Performance of the Year in 2017 and LGPS Fund of the Yea (assets under £2.5bn) in 2018. The performance of the LB Bromley Fund managers has undoubtedly added value to

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	performance by asset class net of total costs is at least comparable with market performance for similar risk profiles.	the Fund. In addition, long term investing has had the benefit of allowing a manager to fully imbed Environmental, Social and Governance (ESG) factors into their investment philosophy. These issues have relevance over the longer timescale. ESG factors do not do as well with passive investing, the timescales are much shorter and the manager does not have time to build the constructive dialogue with the companies they are investing in. To illustrate the benefits of active fund management the Council has received net added value of around £100m with two global equity fund managers, compared with the equivalent passive investments.
Section 4 - Governance	4.2 Pool members, through their internal governance structures, are responsible for effective governance and for holding pool companies and other service providers to account. 4.4 Those who serve on Pension Committees and equivalent governance bodies in pool members should therefore take a long term view of pooling implementation and costs. They should take account of the benefits across the pool and across the scheme as a whole, in the interests of scheme	As a pool member, this council supports the principle of holding pool companies and other service providers to account. We would prefer a more direct influence on investments as indicated earlier. This council supports the principle of taking a long term view and believes that the long term view should also apply to investment strategies. The Council has a duty to secure best value to its council tax payers in the short, medium and longer term. It cannot agree to the regulations seeking a direction that could be at the detriment of its council tax

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	members, employers and local taxpayers, and should not seek simply to minimise costs in the short term.	payers, particularly as a pool could make procurement decisions that could have a negative (or less positive) impact on the performance of the fund.
	4.5 Local Pension Boards of pool members have a key role in pool governance, given their responsibilities under the LGPS Regulations 2013 (regulation 106 (1)) for assisting authorities in securing compliance with legislation, and ensuring effective and efficient governance and administration of the LGPS. They can provide additional scrutiny and challenge to strengthen pool governance and reporting, and improve transparency and accountability for both members and employers.	This council will support governance arrangements that improve pool transparency and accountability and allow scrutiny and constructive challenge to take place.
	4.8 Pool members collectively through their pool governance bodies should decide the pool's policy on which aspects of asset allocation are strategic and should remain with the administering authority, and which are tactical and best undertaken by the pool company. Pool governance bodies, when determining where such decisions lie, should be	This guidance considers the trade off between 'choice and lower costs'. Investment return must also be a consideration and pool members should not be compelled to transition assets and forego their choices where proven higher returns are demonstrated.

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	mindful of the trade-off between greater choice and lower costs and should involve the pool company to ensure the debate is fully informed on the opportunities and efficiencies available through greater scale.	
Section 5 - Transition of assets to the pool	5.1 Pool members should transition existing assets into the pool as quickly and cost effectively as possible. Transition of listed assets should take place over a relatively short period.	This council supports the principle that asset allocation should be cost effective, but does not agree that transition of assets will be cost effective if transition must take place over a "relatively short" time period. The Council also supports having a choice to utilize alternative pools, rather than depend on one pool. There is a risk of creating a 'monopolistic' situation by not allowing choice across pools. Any choice should encourage a more proactive approach within pools and help keep a focus on keeping costs low and maximising performance.
	Temporary retention of existing assets 5.4 In exceptional cases, some existing investments may be retained by pool members on a temporary basis. If the cost of moving the existing investment to a pool vehicle exceeds the benefits of doing so, it may be appropriate to continue to hold and manage the existing investment to maturity before reinvesting the funds through a pool vehicle	This council supports the principle in paragraphs 5.4, 5.5 and 5.6 that existing investments may be, for example (per 5.4) "….. should be held to maturity if costs exceed benefits". The council does not agree that such retention should be considered as 'exceptional' or 'temporary'.

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	5.6 "……Pool members should consider the long term costs and benefits across the pool, taking account of the guidance on cost-sharing, and the presumption should be in favour of transition to pool vehicles or moving such assets to the management of the pool company."	This council agrees that all members should take account of long term costs and benefits, but would not support the "presumption….in favour of transition" if it is to the detriment of performance and returns for individual pool members.
Section 6 - Making new investments outside the pool	6.1 Pool members should normally make all new investments through the pool company in order to maximise the benefits of scale.	Section 5 of the guidance suggests regular reviews should be undertaken for retained assets. This council feels that there should be a review and comparison undertaken, between pool returns and potential returns outside the pool, when new investments are due to be made. The Council would wish to have the choice to access a pool with a similar investment product which could generate greater savings, rather than rely on the outcome of negotiation of one pool.
	6.2 A small proportion of a pool member's assets may be invested in local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member. Local assets should: • Not normally exceed an aggregate 5% of the	This council welcomes the opportunity to invest in assets outside the pool. The Council view is that investments should be in the best interest of the fund and council taxpayers and local investment should be on the basis that it represents the best investment choice.

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	value of the pool member's assets at the point of investment. • Be subject to a similar assessment of risk, return and fit with investment strategy as any other investment. 6.3 Pool members may invest through pool vehicles in a pool other than their own where collaboration across pools or specialisation by pools can deliver improved net returns.	This council welcomes the recognition that there may be higher returns outside of their own pool and that investment may be made across pools. This council believes this principle should be extended to wherever improved returns can be delivered.
Section 7 - Infrastructure investment	7.2 There is no target for infrastructure investment for pool members or pools, but pool members are expected to set an ambition on investment in this area. Pool companies may provide pool vehicles for investment in UK assets, or overseas assets, or both, as required to provide the risk and return profile to meet pool member investment strategies. However the Government expects pool companies to provide the capability and capacity for pools over time to move towards levels of infrastructure investment similar to overseas pension funds of comparable aggregate size.	This council's view remains that we should not be directed to invest in particular areas through regulation which could be detrimental to longer term investment returns, and which could also increase costs met by the local council tax payer. The ambition should be to ensure the fund meets the cost of pensions, meets future liabilities and represents the lowest cost to the council tax payers. There is a risk of creating an ambition for a product which may not be in the best interest of the fund.

London Borough of Bromley Response to		
Draft - Local Government Pension Scheme – Statutory Guidance on Asset Pooling		
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Section 8	Section 8 – 'Reporting' requirements	This council supports transparent reporting and compliance with CIPFA guidance. However section 8 underlines that membership of pool will make financial reporting more onerous and potentially add another layer of reporting.
8.2	8.2 In summary, pool member annual reports should include: • opening and closing value and proportion of pooled assets by asset class • opening and closing value and proportion of local assets by asset class • net and gross performance of pooled assets by asset class • total costs of pooled assets by asset class • for actively managed listed assets, net performance by asset class net of total costs compared to appropriate passive indices over a one, three and five year period • net and gross performance of local assets by asset class • total costs of local assets by asset class ▪ asset transition during the reporting year ▪ transition plans for local assets	This council welcomes the receipt of data from the pool. If councils are to comply with this Statutory Guidance and the recently accelerated statutory reporting deadlines, the LCIV Pool will need to provide prompt, timely and accurate data – including transition costs.

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Section/Paragraph Reference	**Extract of Consultation document text**	**LBB Response**
	▪ pool set-up and transition costs, presented alongside in-year and cumulative savings from pooling ▪ ongoing investment management costs by type, with a breakdown between pooled assets and local assets	
	8.7 Pool members should ensure that pool companies report in line with the SAB Code of Cost Transparency. They should also ensure that pool companies require their internal and external investment managers to do so.	The council welcomes transparency from the Pool and its investment managers.
	8.8 Pool members should also ensure that the annual report of the pool company is broadly consistent with the reports of pool members, and with the Scheme Annual Report, in so far as it relates to their investments, and that the report includes a narrative to explain differences. These may arise for example from reporting periods of pool companies which differ from that of the pool member.	This council welcomes prompt provision of transparent data that this paragraph of the guidance entails. The council welcomes the ability to challenge that consistency between Annual Reports will necessitate. The government should include a requirement for the Pool to supply data within timescales to enable its members to meet their statutory reporting deadlines and consistency requirements. .

Appendix Two

Local Government Pension Scheme

Statutory guidance on asset pooling

Contents

Foreword

The reform of investment management in the Local Government Pension Scheme (LGPS) for England and Wales began in 2015 with the publication of criteria and guidance on pooling of LGPS assets, following extensive consultation with the sector. LGPS administering authorities responded by coming together in groups of their own choosing to form eight asset pools.

Through the hard work and commitment of people across the scheme, those eight pools are now operational. Their scale makes them significant players at European or global level, and significant annual savings have already been delivered, with the pools forecasting savings of up to £2bn by 2033. Along the way many lessons have been learnt and great progress has been made in developing expertise and capacity, including in private markets and infrastructure investment.

This is a considerable achievement in itself, but there is still a long way to go to complete the transition of assets and to deliver the full benefits of scale. In the light of experience to date with pooling and the challenges ahead, authorities have requested guidance on a range of issues. The time is now right for new guidance to support further progress.

1 Introduction

1.1 This guidance sets out the requirements on administering authorities in relation to the pooling of LGPS assets, building on previous Ministerial communications and guidance on investment strategies, and taking account of the current state of progress on pooling. It is made under the powers conferred on the Secretary of State by Regulation 7(1) of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the 2016 Regulations). Administering authorities are required to act in accordance with it.

1.2 This guidance replaces the section at pages 7 to 8 of Part 2 of *Guidance for Preparing and Maintaining an Investment Strategy*, issued in September 2016 and revised in July 2017, which deals with regulation 7(2)(d) of the 2016 Regulations. It also replaces *Local Government Pension Scheme: Investment Reform Criteria and Guidance,* issued in November 2015.

2 Definitions

2.1 This guidance introduces a set of definitions for use in this and future guidance, as follows:

'Pool' the entity comprising all elements of a Local Government Pension Scheme (LGPS) asset pool
'Pool member' an LGPS administering authority which has committed to invest in an LGPS pool and participates in its governance
'Pool governance body' the body used by pool members to oversee the operation of the pool and ensure that the democratic link to pool members is maintained (for example, Joint Committees and officer committees)
'Pool company' the Financial Conduct Authority (FCA) regulated company which undertakes selection, appointment, dismissal and variation of terms of investment managers, and provides and operates pool vehicles for pool members
'Pool fund' a regulated unitised fund structure operated by a regulated pool company, such as an Authorised Contractual Scheme (ACS)
'Pool vehicle' an investment vehicle (including pool funds) made available to pool members by a regulated pool company
'Pooled asset' an investment for which the selection, appointment, dismissal and variation of terms for the investment manager is delegated to a regulated pool company, or an investment held in a pool vehicle
'Retained asset' an existing investment retained by a pool member during the transition period
'Local asset' a new investment by a pool member which is not a pooled asset

3 Structure and scale

3.1 All administering authorities must pool their assets in order to deliver the benefits of scale and collaboration. These include:

- reduced investment costs without affecting gross risk-adjusted returns
- reduced costs for services such as custody, and for procurement
- strengthened governance and stewardship and dissemination of good practice

- greater investment management capacity and capability in the pool companies, including in private markets
- increased transparency on total investment management costs
- diversification of risk through providing access to a wider range of asset classes, including infrastructure investments

3.2 In order to maximise the benefits of scale, pool members must appoint a pool company or companies to implement their investment strategies. This includes:

- the selection, appointment, dismissal and variation of terms of investment managers, whether internal or external
- the management of internally managed investments
- the provision and management of pool vehicles including pool funds

It is for the pool companies to decide which investment managers to use for pool vehicles, including whether to use in-house or external management. Pool members may continue to decide if they wish to invest via in-house or externally managed vehicles.

3.3 Pool companies may be wholly owned by pool members as shareholders or may be procured and appointed by the pool members as clients.

3.4 A pool company must be a company regulated by the Financial Conduct Authority (FCA) with appropriate FCA permissions for regulated activities. This helps ensure the pools comply with financial services legislation, and provides additional assurance to scheme members and employers. Depending on the structure of the pool, appropriate permissions may include permissions for execution, acting as agent, provision of advice, or such other permissions as required by the FCA. Where regulated funds (e.g. in an ACS) are operated by the pool company it should comply with relevant UK legislation.

Regular review of services and procurement

3.5 Pool governance bodies, working with the pool company, should regularly review the provision of services to the pool, and the process of procurement, to ensure value for money and cost transparency. Where services are procured or shared by pool members, pool members should regularly review the rationale and cost-effectiveness of such arrangements, compared to procurement and management through the pool company. Pool members and pool companies should consider using the national LGPS procurement frameworks (www.nationallgpsframeworks.org) where appropriate.

Regular review of active and passive management

3.6 Pool members, working with the pool company, should regularly review the balance between active and passive management in the light of performance net of total costs. They should consider moving from active to passive management where active management has not generated better net performance over a reasonable period. Pool members should also seek to ensure performance by asset class net of total costs is at least comparable with market performance for similar risk profiles.

4 Governance

4.1 Pool members must establish and maintain a pool governance body in order to set the direction of the pool and to hold the pool company to account. Pool governance bodies should be appropriately democratic and sufficiently resourced to provide for effective decision making and oversight.

4.2 Pool members, through their internal governance structures, are responsible for effective governance and for holding pool companies and other service providers to account. Strategic asset allocation remains the responsibility of pool members, recognising their authority's specific liability and cash-flow forecasts.

4.3 Members of Pension Committees are elected representatives with duties both to LGPS employers and members, and to local taxpayers. Those who serve on Pension Committees and equivalent governance bodies in LGPS administering authorities are, in many ways, required to act in the same way as trustees in terms of their duty of care to scheme employers and members, but are subject to a different legal framework, which derives from public law. In particular while they have legal responsibilities for the prudent and effective stewardship of LGPS funds, LGPS benefits are not dependent on their stewardship but are established and paid under statute in force at the time.

4.4 Those who serve on Pension Committees and equivalent governance bodies in pool members should therefore take a long term view of pooling implementation and costs. They should take account of the benefits across the pool and across the scheme as a whole, in the interests of scheme members, employers and local taxpayers, and should not seek simply to minimise costs in the short term.

4.5 Local Pension Boards of pool members have a key role in pool governance, given their responsibilities under the LGPS Regulations 2013 (regulation 106 (1)) for assisting authorities in securing compliance with legislation, and ensuring effective and efficient governance and administration of the LGPS. They can provide additional scrutiny and challenge to strengthen pool governance and reporting, and improve transparency and accountability for both members and employers.

4.6 Local Pension Boards may also provide a group of knowledgeable and experienced people from which observers may be drawn if pool members wish to include observers on pool governance bodies.

Strategic and tactical asset allocation

4.7 Pool members are responsible for deciding their investment strategy and asset allocation, and remain the beneficial owners of their assets, in accordance with *Guidance for Preparing and Maintaining an Investment Strategy.*

4.8 Pool members collectively through their pool governance bodies should decide the pool's policy on which aspects of asset allocation are strategic and should remain with the administering authority, and which are tactical and best undertaken by the pool company. Pool governance bodies, when determining where such decisions lie, should be mindful of the trade-off between greater choice and lower costs and should involve the pool company to ensure the debate is fully informed on the opportunities and efficiencies available through greater scale.

4.9 Providing pool members with asset allocation choices through an excessively wide range of pool vehicles or investment managers will restrict the pool company's ability to use scale to drive up value. On the other hand maximising scale by significantly limiting asset allocation options may not provide all pool members with the diversification needed to meet their particular liability profile and cash flow requirements. Pool members should set out in their Funding Strategy Statement and Investment Strategy Statement how they,

through the pool governance body, have balanced these considerations and how they will keep this under regular review.

4.10 Where necessary to deliver the asset allocation required by pool members, pool companies may provide a range of pool vehicles and in addition arrange and manage segregated mandates or access to external specialist funds. Pool governance bodies should ensure that their regulated pool companies have in place the necessary permissions to enable pool vehicles to be made available where appropriate.

4.11 Determining where asset allocation decisions lie will not be a one-off decision as pool member requirements will change over time. Pool governance bodies should ensure that a regular review process, which involves both pool members and pool companies, is in place.

5 Transition of assets to the pool

5.1 Pool members should transition existing assets into the pool as quickly and cost effectively as possible. Transition of listed assets should take place over a relatively short period.

5.2 Pool governance bodies, working with pool companies and, where appointed, external transition managers, should seek to minimise transition costs to pool members while effectively balancing speed, cost and timing, taking into account exit or penalty costs and opportunities for crossing trades.

5.2 The transition process will incur direct or indirect costs which may fall unevenly across pool members. For example, where the selected managers are used by some pool members but not others. In such cases pool members who are already using the selected manager may incur significantly lower (if any) transition costs than those who do not.

5.3 Inter-authority payments (or other transfers of value) may be desirable in order to share these costs equitably between pool members. The Government's view is that such payments are investment costs within Regulation 4(5) of the 2016 Regulations, and payments made by a pool member to meet its agreed share of costs may be charged to the fund of that pool member, whether the payments are made to other pool members, the pool company, or another body by agreement.

Temporary retention of existing assets

5.4 In exceptional cases, some existing investments may be retained by pool members on a temporary basis. If the cost of moving the existing investment to a pool vehicle exceeds the benefits of doing so, it may be appropriate to continue to hold and manage the existing investment to maturity before reinvesting the funds through a pool vehicle.

5.5 In many cases there will be benefits in such retained assets being managed by the pool company in the interim. However pool members may retain the management of existing long term investment contracts where the penalty for early exit or transfer of management would be significant. These may include life insurance contracts ('life funds') accessed by pool members for the purpose of passive equity investment, and some infrastructure investments. Pool members may also retain existing direct property assets where these may be more effectively managed by pool members.

Regular review of retained assets

5.6 Pool members, working with the pool company, should undertake regular reviews (at least every three years) of retained assets and the rationale for keeping these assets outside the pool. They should review whether management by the pool company would deliver benefits. Pool members should consider the long term costs and benefits across the pool, taking account of the guidance on cost-sharing, and the presumption should be in favour of transition to pool vehicles or moving such assets to the management of the pool company.

6 Making new investments outside the pool

6.1 Pool members should normally make all new investments through the pool company in order to maximise the benefits of scale. Following the 2019 valuation, pool members will review their investment strategies and put revised strategies in place from 2020. From 2020, when new investment strategies are in place, pool members should make new investments outside the pool only in very limited circumstances.

6.2 A small proportion of a pool member's assets may be invested in local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member. Local assets should:

- Not normally exceed an aggregate 5% of the value of the pool member's assets at the point of investment.
- Be subject to a similar assessment of risk, return and fit with investment strategy as any other investment.

6.3 Pool members may invest through pool vehicles in a pool other than their own where collaboration across pools or specialisation by pools can deliver improved net returns.

6.4 During the period of transition, while pool governance bodies and pool companies work together to determine and put in place the agreed range of pool vehicles, a pool member may make new investments outside the pool, if following consultation with the pool company, they consider this is essential to deliver their investment strategy. This exemption only applies until the pool vehicles needed to provide the agreed asset allocation are in place.

7 Infrastructure investment

7.1 Infrastructure investment has the potential to provide secure long term returns with a good fit to pension liabilities, and form part of investment strategies of authorities. The establishment of the pools was intended to provide the scale needed for cost-effective investment in infrastructure, and to increase capacity and capability to invest in infrastructure.

7.2 There is no target for infrastructure investment for pool members or pools, but pool members are expected to set an ambition on investment in this area. Pool companies may provide pool vehicles for investment in UK assets, or overseas assets, or both, as required to provide the risk and return profile to meet pool member investment strategies. However the Government expects pool companies to provide the capability and capacity for pools

over time to move towards levels of infrastructure investment similar to overseas pension funds of comparable aggregate size.

7.3 Pool companies may provide pool vehicles for investment in existing (brownfield) or new (greenfield) infrastructure, based on an assessment of the benefits and risks in relation to pool member liabilities, and non-financial factors where relevant. Pool members may invest in their own geographic areas but the asset selection and allocation decisions should normally be taken by the pool company in order to manage any potential conflicts of interest effectively, maintain propriety, and ensure robust evaluation of the case for investment.

7.4 For the purpose of producing annual reports, infrastructure assets are defined in the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance *Preparing the Annual Report* as follows:

Infrastructure assets are the facilities and structures needed for the functioning of communities and to support economic development. When considered as an investment asset class, infrastructure investments are normally expected to have most of the following characteristics:

- *Substantially backed by durable physical assets;*
- *Long life and low risk of obsolescence;*
- *Identifiable and reliable cash flow, preferably either explicitly or implicitly inflation-linked;*
- *Revenues largely isolated from the business cycle and competition, for example, through long term contracts, regulated monopolies or high barriers to entry;*
- *Returns to show limited correlation to other asset classes.*

Key sectors for infrastructure include transportation networks, power generation, energy distribution and storage, water supply and distribution, communications networks, health and education facilities, social accommodation and private sector housing.

Conventional commercial property is not normally included, but where it forms part of a broader infrastructure asset, helps urban regeneration or serves societal needs it may be.

7.5 All residential property is included in this definition of infrastructure. It is not restricted to social accommodation or private sector housing.

7.6 A variety of platforms may be required to implement the infrastructure investment strategies of pool members. Pool companies are expected to provide access to a range of options over time including direct and co-investment opportunities.

8 Reporting

8.1 Pool members are required to report total investment costs and performance against benchmarks publicly and transparently in their annual reports, following the CIPFA guidance *Preparing the Annual Report*, with effect from the 2018-19 report.

8.2 In summary, pool member annual reports should include:

- opening and closing value and proportion of pooled assets by asset class
- opening and closing value and proportion of local assets by asset class
- net and gross performance of pooled assets by asset class

- total costs of pooled assets by asset class
- for actively managed listed assets, net performance by asset class net of total costs compared to appropriate passive indices over a one, three and five year period
- net and gross performance of local assets by asset class
- total costs of local assets by asset class
- asset transition during the reporting year
- transition plans for local assets
- pool set-up and transition costs, presented alongside in-year and cumulative savings from pooling
- ongoing investment management costs by type, with a breakdown between pooled assets and local assets

8.3 Investments should be classed as pool assets on the basis of the definition in the CIPFA guidance *Preparing the Annual Report.*

For the purpose of defining those assets which are classed as being within an asset pool, 'pooled assets' are those for which implementation of the investment strategy – i.e. the selection, appointment, dismissal and variation of terms for the investment managers (including internal managers) – has been contractually, transferred to a third party out with the individual pension fund's control.

8.4 Any investment where a pool member retains the day to day management, or the responsibility for selecting or reappointing an external manager, is not a pool asset.

8.5 Pool members should provide a rationale for all assets continuing to be held outside the pool, including the planned end date and performance net of costs including a comparison which costs of any comparable pool vehicles. They should also set out a high level plan for transition of assets.

8.6 The SAB will publish an annual report on the pools based on aggregated data from the pool member annual reports, in the Scheme Annual Report. Pool members should comply with all reasonable requests for any additional data and information from the SAB to enable it to publish a comprehensive report.

8.7 Pool members should ensure that pool companies report in line with the SAB Code of Cost Transparency. They should also ensure that pool companies require their internal and external investment managers to do so.

8.8 Pool members should also ensure that the annual report of the pool company is broadly consistent with the reports of pool members, and with the Scheme Annual Report, in so far as it relates to their investments, and that the report includes a narrative to explain differences. These may arise for example from reporting periods of pool companies which differ from that of the pool member.

8.9 Pool members are required to report any change which results in failure to meet the requirements of this guidance to the LGPS Scheme Advisory Board (SAB) and to MHCLG.