

Agenda

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PENSIONS COMMITTEE
28 JUNE 2016**WORCESTERSHIRE COUNTY COUNCIL POOL BUSINESS**
CASE

Recommendation

1. **The Chief Financial Officer recommends that the Worcestershire County Council pool business case be endorsed.**

Background

2. The DCLG has instructed the Administering Authorities of the English and Welsh Funds that comprise the LGPS to make arrangements to reorganise the management of their Fund investments within collective Pools comprising of at least £25 billion of assets under management. The formative Pools are due to provide their proposed Business Cases to the DCLG by 15 July 2016.

3. DCLG has indicated, since the last meeting of the Pensions Committee that only a Pool submission is required rather than a Pool and Fund submission. DCLG will then offer a view on progress made and offer guidance on the next steps. However, given the significance of this decision point, a more robust diligence exercise has been undertaken on behalf of the Fund on the Pool Business Case prior to the Pool submission to Government.

4. From the outset the over-riding principal has been that the Pool must work for the Fund. As with any project of this nature there will be some benefits, but also some compromises might have to be made in the interests of achieving these objectives.

LGPS Central Pool Business Case

5. The pool business case details; the £35bn scale of the pool, which exceeds the government's requirements, the proposed authorised collective investment vehicle governance arrangements, an estimated base case cost saving over the period 2017/18 to 2032/33 of £183m for the total pool and also the pool's commitment to developing an improved capacity to invest in infrastructure.

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Supporting Information

- Worcestershire County Council pool business case- Appendix 1 (Exempt Information – salmon pages)
- Government pooling criteria – Appendix 2
- LGPS Central governance structure – Appendix 3
- Potential questions – Appendix 4 (Exempt Information – salmon pages)

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

- DCLG Local Government Pension Scheme Investment Reform Criteria and Guidance
- LGPS Central pool business case

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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Appendix 2: Criteria

1.1 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 now invited to submit proposals for pooling which the Government will assess against the criteria in this document. 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.

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

1.3 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. Their submissions should describe:

A. Asset pool(s) that achieve the benefits of scale: The 90 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:

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

- i. 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;
- ii. 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.

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:

- The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
- 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.
- Decision making procedures at all stages of investment, and the rationale underpinning this.

- The shared objectives for the pool(s), and any policies that are to be agreed between participants.
- 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.
- How any environmental, social and corporate governance policies will be handled by the pool(s).
- 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.
- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- 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: 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.

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.

As part of their proposals, authorities should provide:

- A fully transparent assessment of investment costs and fees as at 31 March 2013.
- A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- A detailed estimate of savings over the next 15 years.
- 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.
- 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: 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:

- The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
- 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 existing fund, or "fund of funds" arrangements.
- 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.

LGPS Central Governance Structures

Supervisory body/Ownership structure

Continued Responsibilities:

- Strategic Asset Allocation
- Payment of Benefit
- Liability Management
- Management of investments outside ACS

Administering Authorities

Pensions committees

Acts as the Owners of the ACS Operator

Supports the Shareholders' Forum and provides day-to-day liaison between the Operator and funds

Shareholders Forum

Practitioners Advisory Forum

8 Officers representing each local authority with LGPS and Investment Experience

8 Elected Councillors representing local authority shareholder interest, alongside an independent Chair

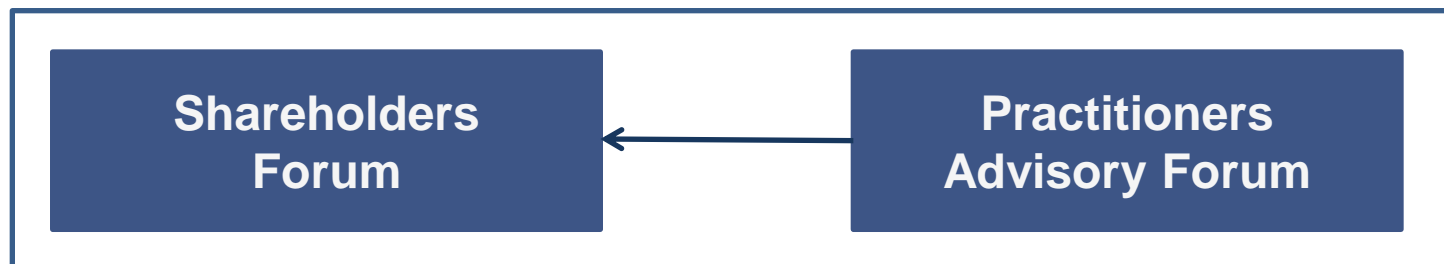
Board of Directors

ACS Operator

Responsibilities:

- Internal investment Management
- External Manager Selection
- Oversight and Performance Monitoring
- Investor Reporting / Communications
- Compliance monitoring (Operator will be supervised by the FCA, as regulator)

Supervisory body/Ownership structure



Act as 'owners' of the Operator. Oversees that the Operator is run in the interests of shareholders by holding final approval over strategic decisions.

Comprised of 8 Elected Councillors representing local authority shareholder interest, alongside an independent Chair

Meet formally on a quarterly basis

- **Example Shareholder powers under the agreement**

- Appoint / remove Directors of the Company
- Approve Annual Business Plan
- Approve Annual Budget (fee model / cost base)
- Approval of Executive Pay (feeding through the Operator's Board usually through Remuneration sub-committee)
- Approve share capital changes to meet regulatory capital requirements
- Approve Significant Transactions (e.g. introduction of new members to the pool)
- Approval / determination of pool exit terms including notice period / exit treatment.
- Approval of RI/ESG policy framework

Support the Shareholders' Forum. Provide day-to-day liaison between the local authority pension funds and the operator.

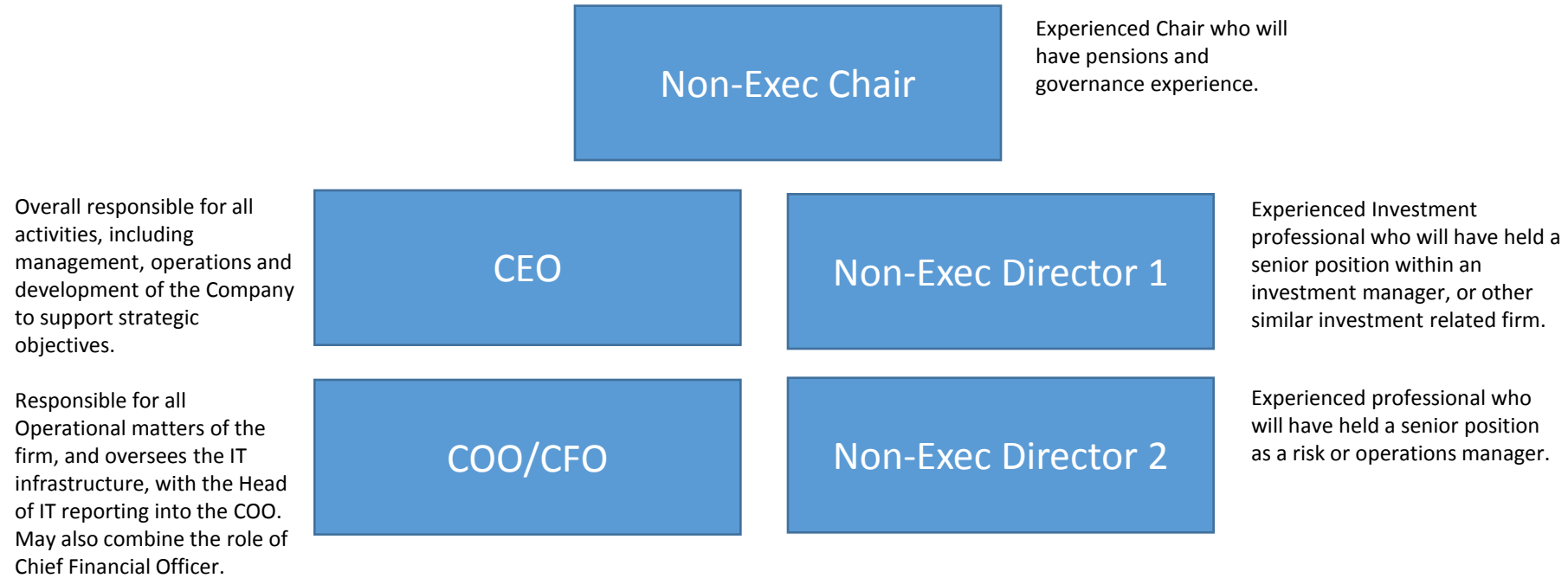
Comprised of 8 Officers representing each local authority with LGPS and Investment Experience

Meet formally on a quarterly basis

- **Example Practitioner activities**

- Provide guidance and advice to the Shareholders Forum
- Provide investment guidance to the Operator
- Review and feedback on Investment Performance
- Provide advice to the Operator on the strategic investment direction

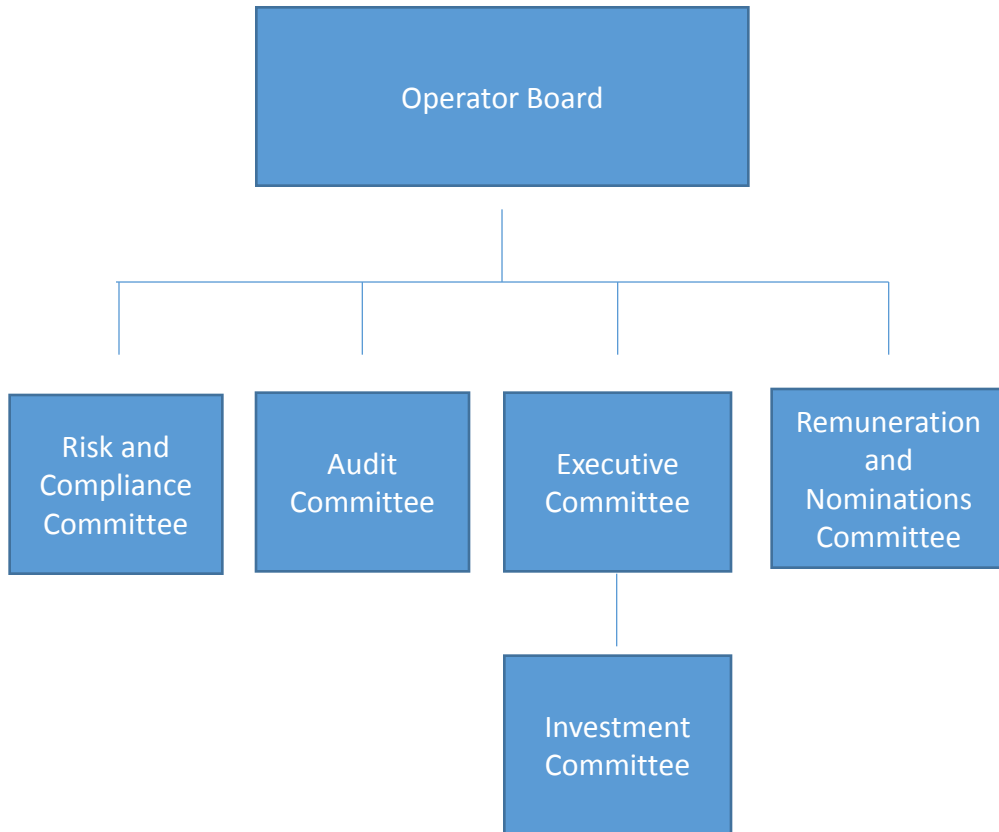
Operator - Board Composition



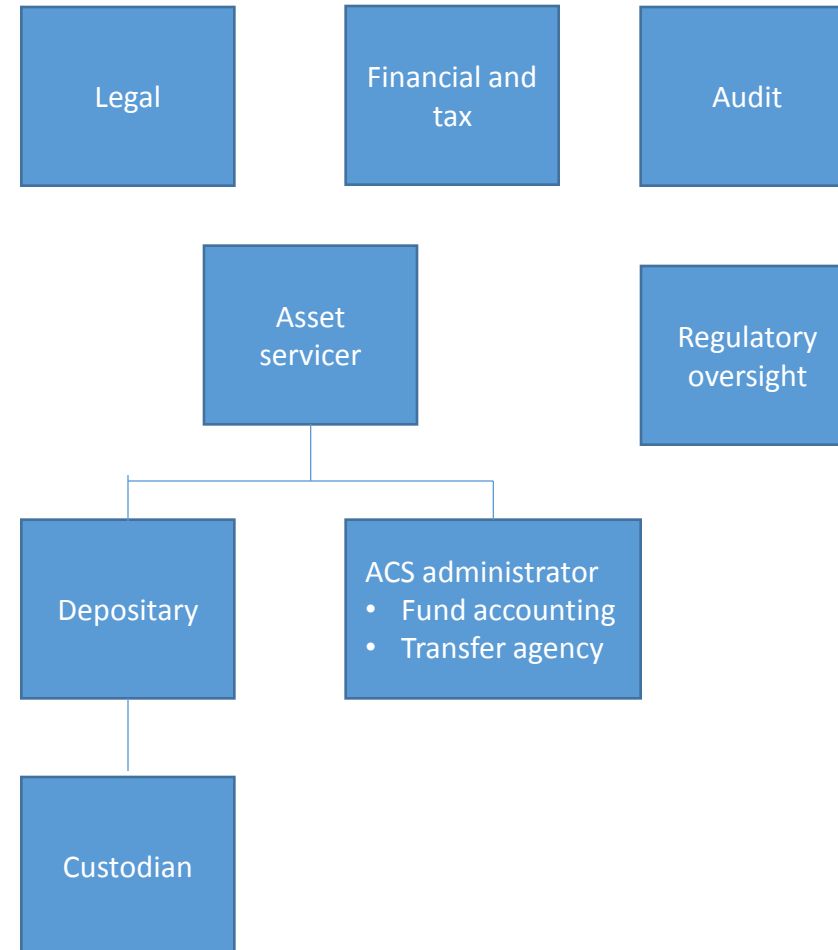
* The Head of Risk, Head of Compliance, Chief Investment Officer and Head of IT would also be expected to be members of the senior management team

Operator and Pool Control Environment

Internal Controls



External Controls



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