worcestershire county council

AGENDA ITEM 10

PENSIONS COMMITTEE
13 MARCH 2017

LGPS CENTRAL COST SHARE

Recommendation

The Chief Financial Officer recommends that the qualification be formally removed, in relation to the approved LGPS Central Governance agenda item recommendations on 7th December 2016, which stated that a cost share agreement is required to be agreed with all LGPS Central pool members that ensures value for money for the Worcestershire County Council Pension Fund from entering into the LGPS Central investment pool.

Background

1. The draft pooling submission to Government in July 2016 included an estimated budget of £3.3 million for set-up costs from July onwards. Following this, tenders were received for the financial and legal advisors, with the successful tenders totalling £400,000 higher than the original estimate.

2. In accordance with LGPS Central's core principle of 'one fund, one vote', and as previously agreed, set-up costs will be divided equally between the participating funds, i.e. one eighth of the actual cost will be met by each fund.

3. The ongoing running costs of LGPS Central in the July 2016 submission were split into equal eighths for the period 1st April 2018 through to 31st March 2021, and then split based on total AUM from 1st April 2021 onwards in order to prevent those transferring assets into the Pool first suffering a heavy burden of costs.

4. Transition Costs (on initial transition of assets into LGPS Central) represent both the largest and difficult to estimate set-up costs. In the Base Case Long Term Cost Savings Model, these were estimated at £40.6 million, and were apportioned according to assets under management, at a 'sub-fund' level.

Revised cost share agreement

5. Subject to the on-going review of the Pool's tax position e.g. Corporation Tax and VAT, for both ACS and non-ACS) the following cost share principles have been agreed by the LGPS Central Programme Board:

a) Set-up costs to be shared equally amongst participating funds, i.e. one eighth per fund.

b) Investment management and monitoring costs to be shared by assets under management (AUM), on a sub-fund by sub-fund basis, subject to a pricing schedule being agreed for different asset classes e.g. active vs. passive and the differing activities of managing and monitoring assets.

c) Corporate governance costs – shared equally amongst participating funds, i.e. one eighth per fund;

d) Operator costs – charged by total AUM (from day one);

e) Transition costs - charged by AUM within sub-funds with a condition that if a fund(s) 'throws into the pot' a mix of assets that suffers from liquidity constraints or much larger transition costs than the rest of the assets, then that fund(s) is charged the additional cost.

Cross-subsidisation

6. Based on legal advice obtained by the Brunel Pensions Partnership the sharing of costs on an equitable basis should not involve any element of illegal "subsidy". Cost sharing should be on a fair and equitable basis, so that a reasonable and commercially responsible public authority would enter into it. The LGPS Central programme board and programme delivery group are now considering whether a legal option will need to be obtained in relation to the agreed cost share arrangements for the pool.

Impact on costs

7. The removal of the three years running costs split into equal eighths for the period 1st April 2018 through to 31st March 2021 results in a £0.9m better off position for the fund after a 16 year period (with 2018/19 as year 1). The breakeven point is also two years earlier in 2031/32 rather than 2033/34 as per under the original proposal. The biggest beneficiary, in absolute cash terms, is Shropshire which is £1.2m better off over 15 years (to 2032/33). All the other funds break even or gain, except the West Midlands, which incurs a reduction in savings of c. £3.2m, however it still remains the Fund with the largest £ savings in the pool.

8. The LGPS Central business case will be rerun at various key stages over the next few years. The first planned rerun will take into account the full details of the revised cost share agreement and the proposed sub-fund structure. More savings are expected to result for the Worcestershire County Council Pension Fund through the revised cost share for investment management and monitoring costs, which will be priced on a sub-fund basis rather than asset under management. As the Fund invests a substantial proportion of its assets in pooled passive equity funds, these are expected to have a lower 'price' than an active equity mandate or an alternatives mandate and therefore relative to other Funds in the pool will incur a lower cost.

9. It has also been agreed that the transition plan for Emerging Market equities will be brought forward compared to the base case in the July submission and therefore the Fund should benefit from increased savings earlier than originally planned.

Supporting Information

Appendix 1 Programme Board: Cost-Sharing Principles Proposal

Contact Point for this Report

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Background Papers

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

LGPS Central business case submission to government 15 July 2016.