

PENSIONS COMMITTEE
17 MARCH 2020**LOCAL GOVERNMENT PENSION SCHEME (LGPS)**
CENTRAL UPDATE

Recommendation

1. **The Chief Financial Officer recommends that the LGPS Central Update be considered and noted.**

Background

2. The Government set out in 2014 its approach and reasoning (Opportunities for collaboration, cost savings and efficiencies) for asset pooling with responsibility for asset allocation staying with the 90 administering authorities. Worcestershire Pension Fund (WPF) in collaboration with eight other Local Authorities (Cheshire, Leicestershire, Shropshire, Staffordshire, the West Midlands, Derbyshire, Nottinghamshire, and the West Midlands Integrated Transport Authority) set up a collective investment vehicles called LGPS Central. The Company was authorised to operate as an Alternative Investment Fund Manager (AIFM) and became formally operational from the 1 April 2018.

3. LGPS Central has been in operation just under 2 years and several the local authorities have transitioned some of their existing asset allocations to be managed by the company. WPF transferred its Active Emerging Market funds into the LGPS Central's Global Active Emerging Market managed mandate in July 2019.

Transition of Assets

4. The next planned fund to transition across is the Corporate Bonds mandate which should be completed this month and has been detailed within the Pensions Investment update on this agenda.

LGPS Central Draft Strategic Business Plan & proposed budget for 2020/21.

5. Each year LGPSC is required to produce an updated budget and Strategic Business Plan. An update was provided to the Committee on the 31 January 2020. The intention of the Company and Practitioners Advisory Forum (PAF) which has key representation from lead officers for each of the Partner funds was to take an agreed set of papers to the Shareholder Forum which was being held on the 11 February 2020.

6. However, there were still several areas in negotiation at this time and the Shareholders meeting was rearranged to the 20 March 2020.

7. In setting the budget and business plan for the current financial year being 2019/20 Partner Funds jointly undertook rigorous due diligence on the proposed operating budget, which involved comprehensive analysis of the Company's proposed items of expenditure and a series of negotiations with the Company's senior management team.

8. This was the same for 2020/21 with a dedicated Finance working group (FWG) set up who initially met with representatives from LGPSC on the 5th November to begin discussions and have been ongoing since November, finally reaching a point at which the FWG were prepared to support the 2020/21 budget proposed by LGPS Central on the 4 March which was subsequently discussed at the monthly PAF meeting on the 5 March 2020.

9. In the 31 January 2020 report to Committee, LGPS were seeking an annualised budget of £13.110m compared to the 2019/20 annualised budget of £11.158m an increase of 17.5%. After further negotiation by FWG (mainly reducing staffing assumptions and pay increases) the proposed annualised budget presented at PAF on the 5 March 2020 was £12.211m an increase of 9.4%. The key reasons for the increase are due to costs linked to new products & services £0.677m and strengthening infrastructure £0.421m.

10. However, £0.377m of the items removed from the budget are expected to be presented for in-year approval as they relate principally to six products & services (Funds: property; private equity vintage 2020; targeted return & global small-cap. Services: sustainable equities & LDI, LGPSC has acknowledged that the global small cap & targeted return funds are currently programmed for April 2021 launches). If all of these were agreed in year, then this would increase the annualised budget to £12.588m an increase of 12.8%

Cost Saving 2020/21

11. To recap the updated 2019 Cost Savings Model presented to Committee in January was forecasting £284m of collective cost savings from the launch of the Pool in April 2018 to March 2034. This forecast was based on:

- post management fee cost transparency review opening total expense ratio's (TERs) for 18/19
- LGPSC proposed phased budget of £12.4m for 20/21, thereafter an annualised budget of £13.1m (Will now be revised to £12.2m)
- fairly demanding future TER assumptions

12. The 2019 Cost Savings Model presented in January suggested:

- that the Pool will 'break-even' in 2025/26, one year later than suggested by the 2017 Cost Savings Model – two Partner Funds, together with the ITA, currently fail to breakeven
- gross savings of £365m need to be achieved to cover cash outflows over the life of the model (principally: £236m of LGPSC entity operating costs, £68m of transition costs and £39m of service provider fees) before positive cost savings can be achieved
- on average, Partner Funds will receive around 40p in the pound of gross cost savings

13. The estimated impact for Worcestershire Pension Fund (WPF) is a forecast loss of £0.281m at the end of 2033/34 compared to the £3.977m saving in the original model.

14. Out/Underperformance has the potential to overwhelm cost savings with each +/- 10bp in net relative performance adding or subtracting £320m to/from cumulative savings over the life of the model.

15. Although an updated cost sharing model with the proposed revised budget is not yet available, the proposed budget reduction from that previously presented, is likely to have a minimal impact for Worcestershire Pension Fund (WPF) on the cost sharing highlighted in January 2020.

31 January Committee resolution

16. The Committee agreed that in light of the fact that the Shareholders Forum meeting was likely to take place in advance of the next scheduled meeting of the Committee and to avoid any unnecessary delay, the Chief Financial Officer be given delegated authority, in consultation with the Chairman of the Committee to carry out due diligence on the LGPS Central budget updated proposals and to enable the Chairman as Shareholder to agree the proposed 2020/21 LGPSC budget unless the updated budget extended the break-even position of the WPF beyond 2038 thereby impacting on the original cost-sharing agreement.

Strategic Business Plan (SBP) 2020/21

17. The papers for the Shareholders meeting on the 20 March were sent out by LGPSC on the 5 March 2020. Part of the papers were the proposed SBP attached as an Appendix. Members will note that the budget contained in the SBP is £11.443m which is a phased budget and the £12.221m highlighted in para graph 9 above is the equivalent annualised (full year effect) budget for 2020/21.

18. It should be noted that a unanimous decision from Shareholders is required to approve any such increase.

Staffing

19. LGPSC have been looking to build resources in the Private Markets team to facilitate the launch of new sub-funds, manage Partner Funds' legacy assets, generate investment cost savings and develop the internal investment capability for the collective benefit of Partner Funds. At the time of writing this report LGPSC were in the later stages of appointing a Head of Private Markets

20. A new Non-Executive Director, Susan Martin has recently been appointed.

Annual Stakeholders meeting 11 March 2020

8. This meeting was attended by some of our members and was an opportunity to access LGPSC progress and meet some of the individual Fund managers.

PAF Working Groups

9. PAF have a number of Work streams which meet regularly and aims to work closely with LGPS Central to ensure that all the funds requirements are met. These are

- Client Oversight and Governance Group
- Investment Working Group
- Responsible Investment Working Group
- Finance Working Group

10. Considerable focus continues to be placed on the client agreements that LGPS Central need to have in place as these are still outstanding. However, the Fund performance reports have developed well since the last report and are now mostly in a format that the partner funds require.

11. There are regular individual partner fund meetings with the Head of Client Service and Stakeholder Engagement. LGPSC also provide detailed updates to the monthly Practitioner Advisory Forum (PAF) Meetings.

12. Please note that the Appendix contains exempt information (on salmon pages) and should members wish to discuss the information included in these Appendices they would need to consider passing the appropriate resolution and moving into exempt session.

Contact Points

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Supporting Information

- Appendix – 2020/21 LGPSC Strategic business plan and budget (**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:

- LGPS Central business case submission to government 15 July 2016.
- Minutes of the Pensions Committee on the 31 January 2020
- Minutes of the Shareholders meeting on the 1 November 2019