worcestershire
countycouncil

Pension Committee
30 September 2015

6. LGPS COLLABORATIVE WORKING

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) the update regarding the wider national position in respect of collaboration within the LGPS be noted; and

   b) he be granted delegated authority to conclude the matter of a joint procurement of a passive investment manager with six other LGPS administering authorities.

Purpose of the Report

2. To update the Committee on the wider national position in respect of collaboration within the LGPS, and in particular the potential impact of an announcement contained within the Summer Budget.

3. To inform the Committee of discussions that have been taking place with other Local Government Pension Scheme (LGPS) Administering Authorities, and to seek formal delegated power to continue this work.

Background Information

4. In May 2013 the then-Local Government Minister made clear in a speech that the structure of the LGPS was being considered, with Fund mergers a possibility for consideration. This speech was followed by a 'Call for Evidence' consultation that focused on the management of deficits and investment efficiency.

5. In May 2014, and following analysis of the responses received from the Call for Evidence, a further round of consultation was launched. This consultation ruled out forced Fund mergers in the near term and focused on the possibility of asset pooling (possibly via the formation of a small number of Common Investment Vehicles) and the increased use of passive management, both of which were thought to offer potentially significant savings in investment management fees across the LGPS.

6. The Summer Budget of July 2015 contained the following announcement:

> "The government will work with the 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."

DCLG update 21 August 2015

7. On 21 August 2015 DCLG provided a verbal update on forthcoming government requirements for LGPS collaboration and investment pooling. Set out below are the key messages from the meeting:

7.1 Government Criteria for LGPS Collaboration

- No further consultations will be launched and the government will issue criteria in early November 2015 for the LGPS to have regards to when developing proposals, which will be due by March 2016, for increased collaboration and investment pooling.

- The published criteria is likely to include scale of pooling, which is likely to be minimum £30bn for each pooled fund / CIV.

- The government is putting the onus on the LGPS to develop the proposals but are likely to require five proposals similar to 'beefed up' versions of the London CIV. Ministers are however not wedded to CIVs and are open to considering other options.

- Proposals should address costs and demonstrate efficiency savings along with maintaining / improving investment returns.

- Each LGPS scheme will retain responsibility for strategic asset allocation decisions at an individual fund level.

- Ministers' focus has now moved from pure cost savings towards scale and the associated financial and non-financial benefits achievable through economies of scale. No target savings figure is held by the treasury but an increase in passive investment is expected based on the evidence to date.

- Internally managed funds are to be included and will be required to pool to reach the £30bn minimum scale.

- There will be room at the margins for investment outside of the pools, for example, local infrastructure investments, and investments such as limited partnership alternative investments that can't be disinvested at a reasonable cost.

7.2 Legislation

- The government will formally respond to the last consultation and will be updating the LGPS Investment Regulations. Ministers are open to proposals to change the regulations to enable the required LGPS investment pooling.

- Backstop legislation will be introduced to force non-conforming funds into the large investment pools. If proposals provided are not in-line with criteria set the government could enforce a national CIV or more likely make changes through LGPS investment regulations to force change.

7.3 Timeline

- The Chancellor will want to report progress at the next budget in March 2016, so proposals will be required by that date or at least a direction of travel fully established e.g. which groups are coming together to form the pools.
- Ministers are realistic concerning the time required to set-up pooled vehicles / CIVs but expect the pools, to be implemented and funded in the lifetime of this parliament, so three to four years is likely to be acceptable. A degree of pace will however be required.

Passive Equity Collaborative Working with LGPS

8. For a number of months the Fund has been in discussions with six other Administering Authorities about the possibility of a joint procurement of passive investment management. This work was started by

Funds

the Cheshire and Staffordshire Funds and the seven Funds now involved appear to have sufficient ‘critical mass’ to be able to jointly procure passive investment management services at a cost that is significantly lower than the individual Funds are currently paying.

9. When it became apparent that the discussions had reached a point at which action seemed the likely outcome, the Chairman of the Pension Investment Advisory Committee and the Chairman of the Pension Committee were informed.

10. A meeting of six of the Funds was held on 14 August (the seventh was unavailable due to other commitments), and the discussions were extremely encouraging. There was a clear common goal and willingness to proceed in a timely manner; in fact, the group was able to agree every point of importance. There was agreement of the need to appoint an investment consultant to carry out work in respect of the optimal outcome for the group, and five consultants were approached to put forward submissions for how they would carry out this work. Bfinance were selected following this competitive tender and the Funds involved are currently working with Bfinance to design the criteria for the pooled passive manager tender.

11. The seven Funds believe that they have sufficient assets to ensure that the investment management fees achieved will be extremely attractive. It is hoped that the whole process, including restructuring any assets that will require transferring between investment managers, will be completed before the end of October 2015. This timetable is ambitious but it is believed that it can be achieved. There will also be an opportunity for other Funds to join the group in the future, which may attract sufficient assets to meet the government's scale criteria.

12. The outcome of the joint procurement will almost undoubtedly be that all of the Funds involved will have the same passive investment manager, as opposed to the four different ones that are currently used. It is expected that the appointed manager will be able to provide pooled funds that replicate the indices that are already used by the individual funds, although there is a willingness on the part of the Funds to make slight revisions to their benchmarks (e.g. moving to the regional components of the MSCI indices for overseas equities, rather than the FTSE equivalent) if this is beneficial.

13. It is difficult to be specific about the likely fee savings in advance of the procurement, but informal discussions between Cheshire and Staffordshire and some of the potential managers suggest that they will be very worthwhile. Passive management fees are low and in comparison to those charged by active managers, but it seems likely that a reduction of about 30% - 50% is achievable.

14. In order to allow smooth progress towards the joint appointment it is recommended that the Pension Committee delegate the procurement and possible termination of the Fund's incumbent passive manager (UBS) to the Chief Financial Officer, who will consult with the Chairman on all matters of importance. If the successful investment manager is our incumbent passive manager (UBS), no action other than the signing of a new fee agreement will be necessary.

Contact Points

County Council Contact Points
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Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relevant to this report.