

PENSIONS COMMITTEE

27 APRIL 2016

LGPS ASSET POOLING

Recommendation

1. **The Chief Financial Officer recommends that:**
 - a) **The LGPS Asset Pooling Report be noted; and**
 - b) **The CIV structure (option 1) be approved as the preferred pool structure and the Chief Financial Officer be authorised to support the development of the submission of the Pool to Government on that basis.**

Background

2. In the July 2015 Budget, the Chancellor announced the Government's intention to work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs while maintaining overall investment performance.

3. On 25 November 2015, DCLG published its response to the May 2014 consultation (Opportunities for collaboration, cost savings and efficiencies). It said responsibility for asset allocation would stay with the 90 administering authorities and that savings could be delivered through the use of asset pooling and, in particular, collective investment vehicles. Following discussions with local government and the fund management industry over the summer, the Government prepared criteria against which the authorities' proposals for pooling would be assessed. Authorities were asked to develop proposals for pooling assets in line with the timeline detailed below.

The 4 main criteria are:

- Criteria 1: Asset pool(s) that achieve the benefits of scale c. £25bn
- Criteria 2: Strong governance and decision-making
- Criteria 3: Reduced costs and excellent value for money
- Criteria 4: An improved capacity and capability to invest in infrastructure.

4. Strategic asset allocation will remain a local decision for the administering authority and local pension committee. The pool, through the appropriate Governance process that will be defined by the July submission will decide on investment manager appointments and the type and number of sub-funds. Elected members of each Fund will influence how each pool operates.

5. Worcestershire County Council Pension Fund in collaboration with eight other Local Authorities under the brand 'LGPS Central' submitted their initial proposals to the Government by 19 February 2016. For ease of reference, this submission is attached as Appendix 2 to this paper.

6. The government responded to the LGPS Central February submission on 24 March 2016, Appendix 3, welcoming the initial proposal and encouraging the pool to continue with the planned work to develop a detailed submission that fully addresses the criteria by 15 July 2016.

7. By **15 July 2016** Funds must make a final submission which fully addresses the criteria set out above, with enough information for the proposal to be evaluated by government. Each pool must make a submission which covers the joint proposals and describes the proposed governance, structure and implementation plan. Each authority must submit an individual return which sets out the profile of costs and savings, the transition profile for the assets and the rationale for any assets which it proposes to hold outside the pool.

8. All costs incurred to date by the Fund in relation to LGPS Central and those predicted to be incurred through to the July submission are within the limit delegated to the Chief Financial Officer by the Pensions Committee.

Options for Legal/Governance Structure

9. In developing a pooled solution having a clear view on the legal/governance structure of the pool is critical, as it impacts on how the pool will operate in practice and how each Fund has oversight of the management and governance of the pool. In recognition of the importance of this decision LGPS Central jointly procured legal advice from Eversheds, along with the Borders to Coast pool, to consider the benefits and risks of different governance and operating structures for pooling. The accompanying presentation (Appendix 1) details the benefits and disadvantages of the different options. In evaluating the alternative approaches, there are a number of important considerations, including:

- Ownership of the assets
- Tax efficiency of the pool
- Whether assets be managed internally
- Whether it requires FCA registration
- Cost of set up and ongoing costs.

10. In summary, Eversheds have advised that there are two main options for pools to consider:

Option 1 - A structure incorporating an FSMA (Financial Services & Markets Act) registered Collective Investment Vehicle (CIV)

Option 2 - A Joint Committee structure - Collective Asset Pool (CAP)

Further detail of these options is provided in the attached presentation (Appendix 1).

Recommendation of LGPS Central Pool

11. Having considered Eversheds' legal opinion with regards to CIV and CAP options, the unanimous view of all participating Funds in LGPS central is to recommend that the LGPS Central Pool be structured under a regulated CIV structure (Option 1).

12. The key reasons for this recommendation are as follows:

- The CIV structure is the only approach that fully meets the Government's criteria
- Clear and absolute separation of strategic asset allocation and implementation
- Benefits of scale would be maximised, as implementation of the investment strategy is undertaken by a single legal entity
- Strongest and most sustainable governance structure in the short and long term
- Provides optimal structure for the pool to provide internal asset management (one of the key strengths of the LGPS Central proposal)
- Most tax efficient solution
- Removes significant regulatory risks attached to a structure (CAP) designed to fall outside the scope of FCA regulation. It is important to note that if a CAP structure (option 2) were chosen and the pool were deemed by the FSA to be carrying out one or more regulated activities without the appropriate FCA authorisation at any point during the CAP operation period, Elected Members could be subject to criminal prosecution.

13. It should be taken into consideration that the regulated CIV structure option (option 1) does have disadvantages in terms of the resource (time and expense) to establish the structure and ongoing operating costs may be higher than a 'looser' legal structure (option 2).

Next Steps

14. Within a regulated CIV structure there will still be options available to the Pool in terms of how the pool is structured and how it operates. For example one of the key decisions will be whether the pool builds the 'operator' (the FSA authorised and regulated entity who operates the pool) itself or rents it from an existing provider in the market.

15. Another decision facing the LGPS Central Pool (but not all LGPS pools) will be how to structure the internal asset management resource and whether that will be through the 'operator' itself or through the 'operator' contracting with a separate investment management entity.

16. The advantages and disadvantages of these sub-options will be evaluated and costed by the Pool and presented back to this Committee as the business case is developed.

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Supporting Information

- LGPS Central governance structure presentation - Appendix 1
- LGPS Central February submission to government – Appendix 2
- Government response to LGPS Central February submission – Appendix 3

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

Agenda papers and Minutes of the Pensions Committee meetings on 30 September 2015, 14 December 2015 and 3 February 2016