



Worcestershire County  
Council Pension Fund

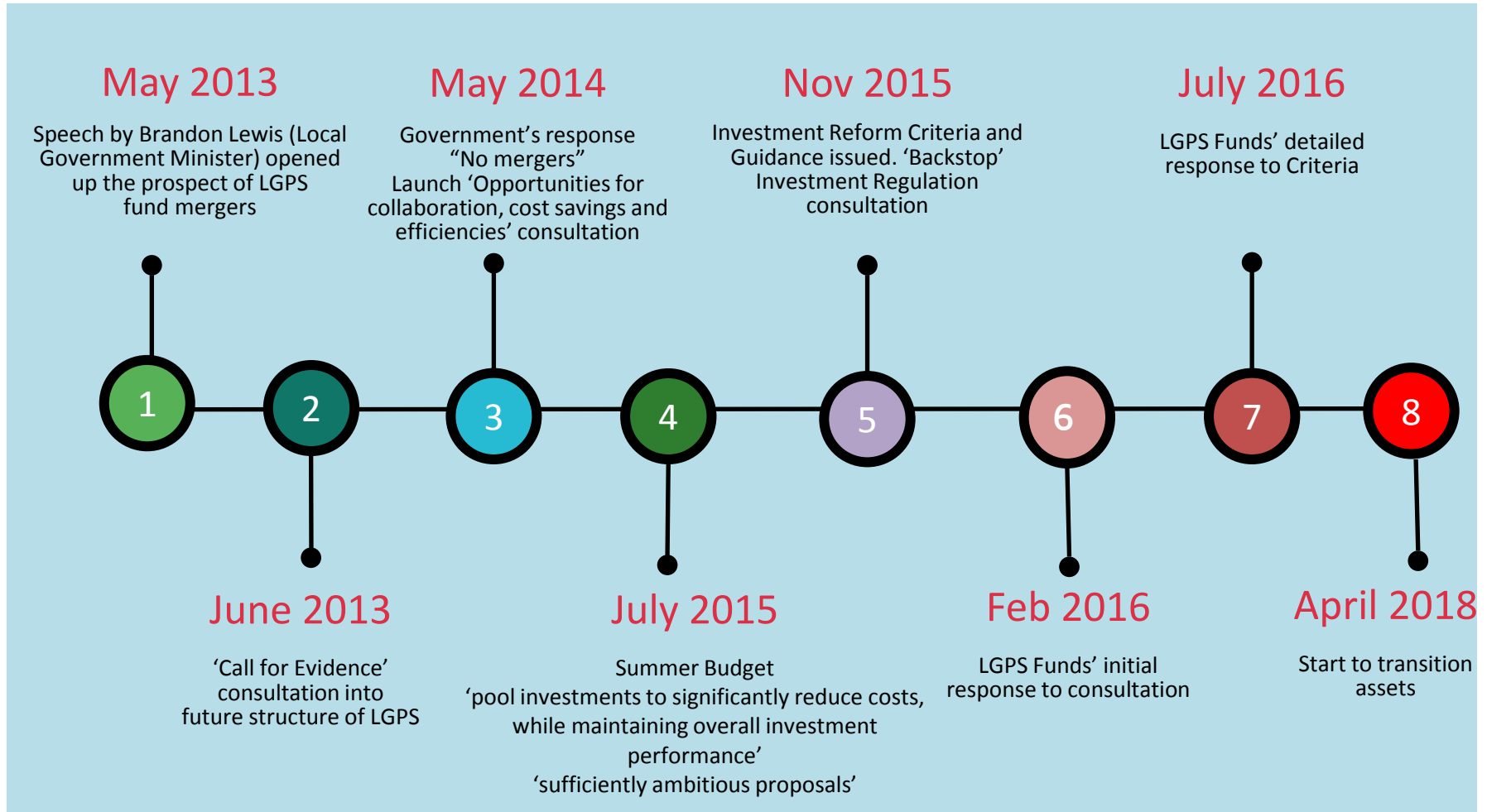
# Investment Pooling Update



## ***Recommendation***

***Members are asked to consider their views and endorse the recommendation that in principle LGPS Central Pool be structured under a regulated CIV structure and that Officers and the Pool proceed on this basis. Any further development of a pooled solution and option appraisal will be limited to options that fall within a regulated CIV structure***

# Story so far



# Government Criteria



1

Benefits of scale (at least £25bn in assets)

2

Strong governance and decision making

3

Reduced costs and excellent value for money

4

An improved capacity and capability to invest in infrastructure

# LGPS Central



£35bn+

Cheshire

Staffordshire

Shropshire

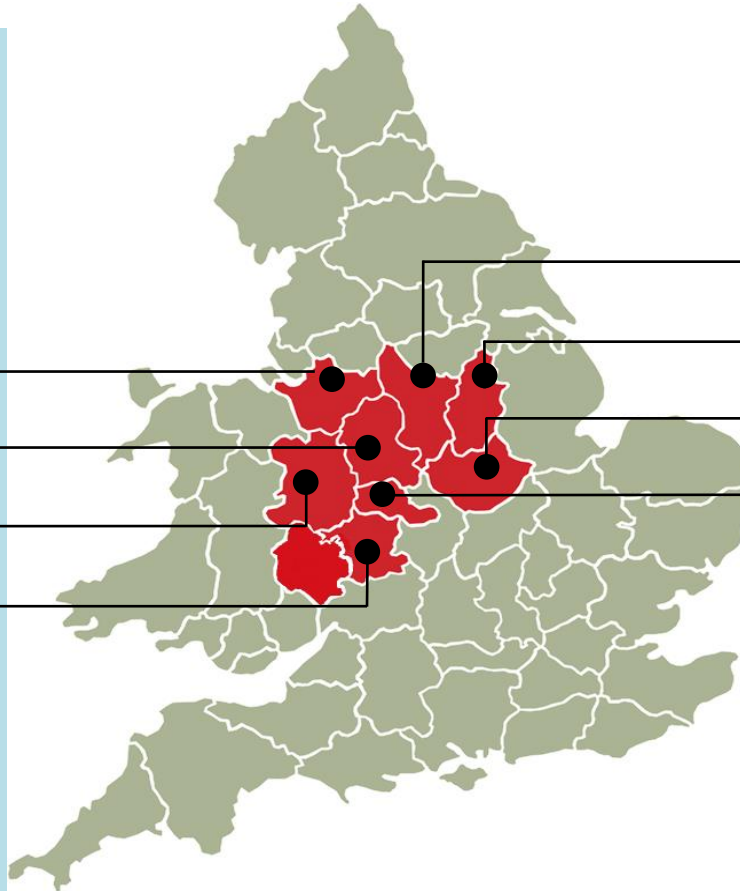
Worcestershire

Derbyshire

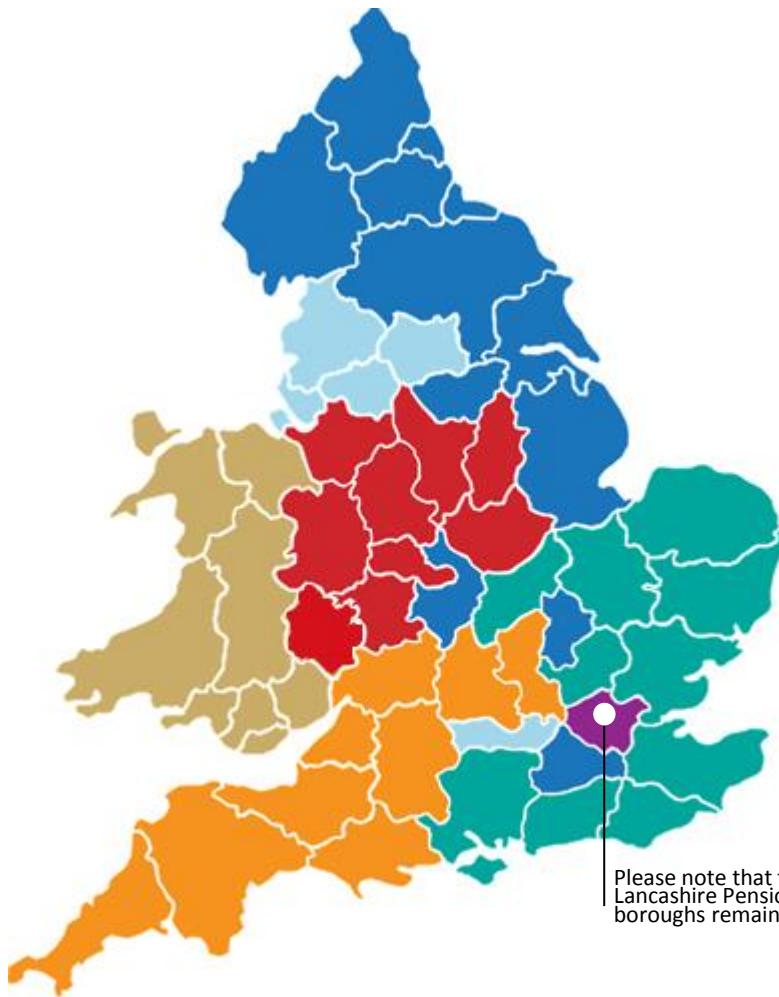
Nottinghamshire

Leicestershire








West Midlands



# Likely Other Pools



Please note that the LPFA has linked with the Lancashire Pension Fund; all other London boroughs remain separate

| Pool  | £bn**      |
|---|------------|
|  Borders to Coast*         | 35         |
|  Access                    | 33         |
|  London                    | 25         |
|  Brunel                    | 23         |
|  Wales                     | 13         |
|  LGPS Central*             | 34         |
|  Northern Powerhouse/LPFA* | 44         |
| <b>Total</b>  | <b>207</b> |

\*Has external and internal management

\*\*As at 31 March 2015

## Work to date

- LGPS Central Funds have like-minded principles
- Statement of Commitment
- One Fund, One Vote a key feature
- Regular cycle of Officer meetings
- Strong commitment
- Chairs, Vice-Chairs and Section 151 Officers event held January 2016 (more planned)
- Joint submission February 2016



# Next Steps – By July 2016



- Develop detailed proposal
  - Legal Structure
  - Governance structure
  - Decision-making processes
  - Implementation timetable
  - Savings
- 1<sup>st</sup> Key decision Legal Structure
- Commissioned Eversheds
- Clear consensus Officer/Group recommendation
- Each Participant Committee to endorse



# Two Options considered



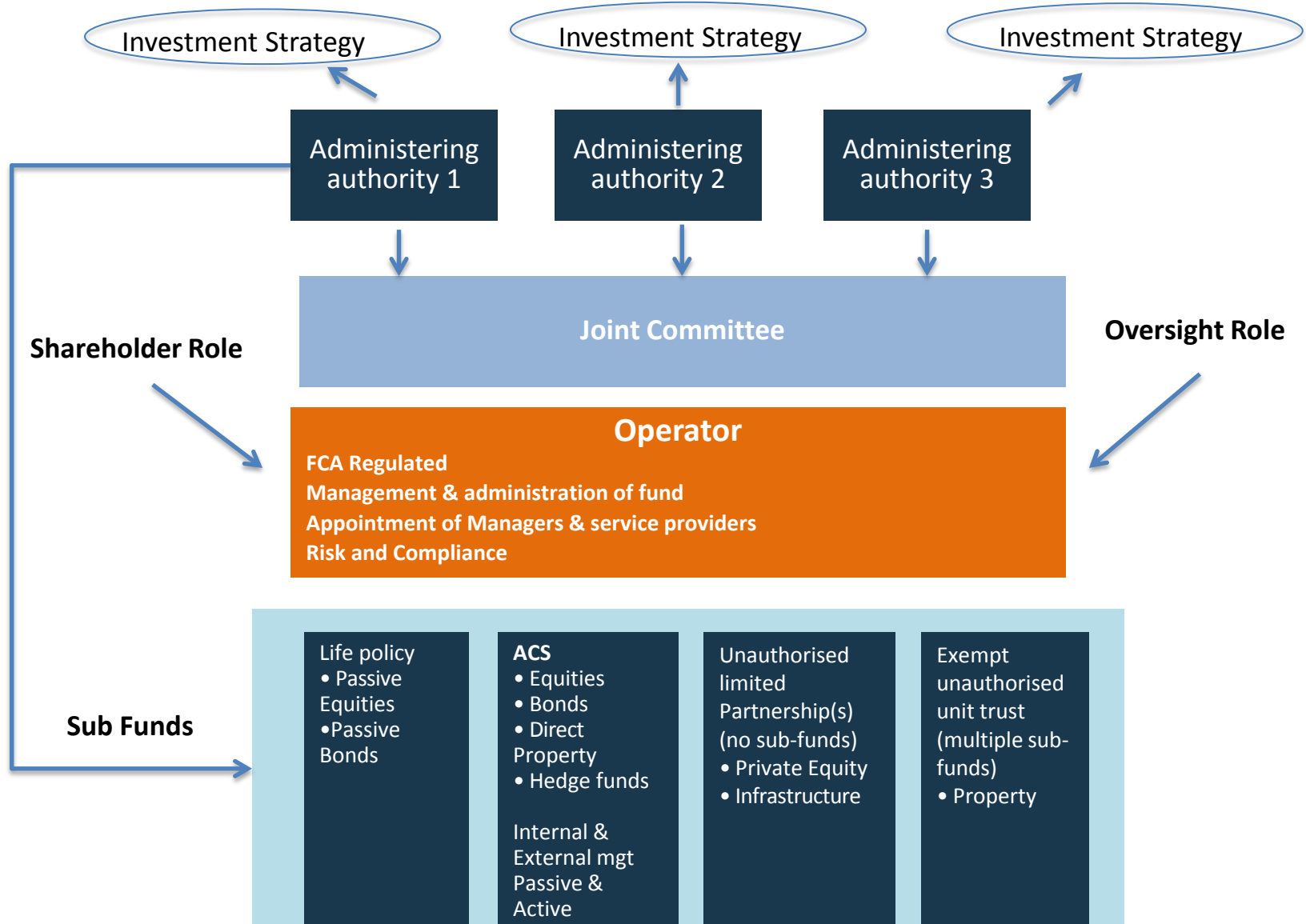
## Option 1

- Collective Investment Vehicle (CIV)
  - Incorporating an FCA Regulated entity

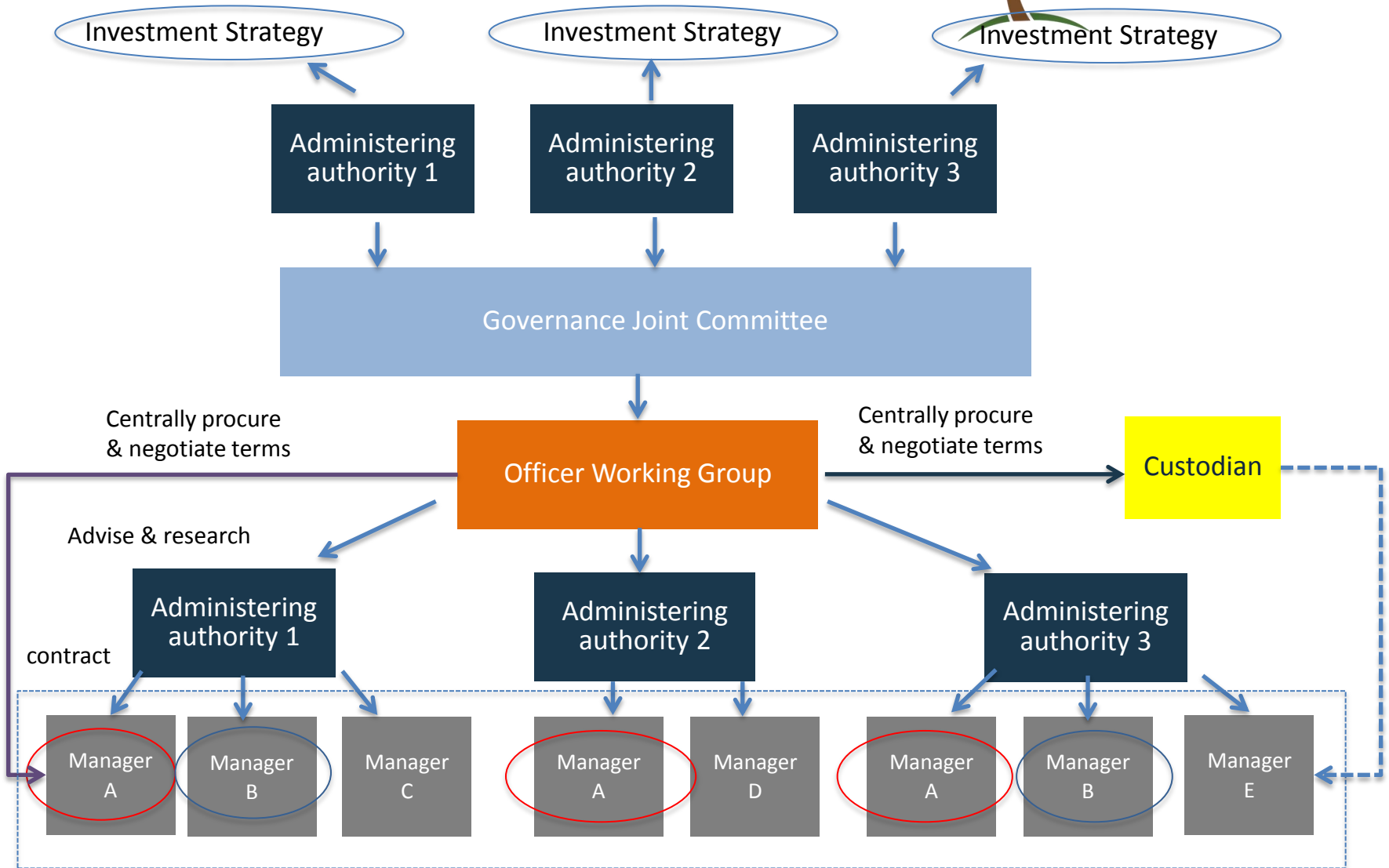
## Option 2

- Combined Asset Pool (CAP)
  - No legal definition
  - Not a separate entity
  - Joint Committee

# Option 1 - CIV



# Option 2 - Combined Asset Pool



## Pros and cons of CIV and CAP

|   | Collective Investment Vehicle |   | Collective Asset Pool |   |
|---|-------------------------------|---|-----------------------|---|
| <b>Government criteria and guidance</b> | ✓✓                            | Designed to comply with all of the criteria.  | •                     | Does not pool ownership of the assets, but only combines governance, oversight, procurement and administration. There is a question of whether this will be sufficient for the Government   |
| <b>Governance</b>                       | ✓✓                            | <p>Strongest governance capabilities. Assurance is given through the joint committee providing oversight and governance over the management of the CIV.</p> <p>Under Option 1A each administering authority is also a shareholder in the Operator and therefore has a significant degree of direct control and influence over the management of the CIV.</p> <p>Under Option 1B each administering authority has less control and influence over the management of the CIV but can influence control through the service agreement with the Operator.</p> <p>The FCA authorisation of the Operator may also be seen to give additional assurances to the administering authority (as may the role of the Depositary).</p> | ✓                     | <p>Under the CAP model the investments remain invested at local fund level so each administering authority retains direct visibility of the assets it directly owns.</p> <p>Each administering authority also has role in the oversight and governance over the management of the central functions of the CAP through the governance joint committee.</p> <p>The CAP would not have additional layer of regulatory governance.</p> |
| <b>Regulatory risk</b>                  | ✓✓                            | Does not have any of the regulatory risks attached to a structure designed to fall outside to the scope of FCA regulation.  | ✗                     | Certain elements that will carry FSMA regulatory risk throughout its lifecycle. This is inherent in seeking to create a structure that is not regulated by the FCA.   |
| <b>Establishment costs</b>              | •                             | A CIV will be more expensive than a CAP to establish at the outset.   | ✓                     | Will be cheaper than a CIV to establish.  |

|                                |   |  |
|--------------------------------|---|--|
| <b>Ongoing operating costs</b> | <ul style="list-style-type: none"> <li>Ongoing operating costs will be an important factor to analyse further. There will be significant costs in operating the structure, however these must be offset against reduced management fees, custody costs, transaction costs, administration costs etc.</li> </ul>         | <ul style="list-style-type: none"> <li>May be cheaper to operate than a CIV. However, there is scope for significant operational costs without the same benefits on savings (as described in the CIV).</li> </ul>  |
| <b>Tax</b>                     | <ul style="list-style-type: none"> <li>✓✓ A robust, clearly defined tax status. Analysis shows that a CIV (particularly an ACS) can be more tax efficient for overseas assets than the LGPS funds investing direct (and hence more tax efficient than the CAP).</li> </ul>  | <ul style="list-style-type: none"> <li>✗ No change to the status quo, and so does not take advantage of the tax efficiencies available with, for example, the ACS for certain asset classes.</li> </ul>  |
| <b>Internal management</b>     | <ul style="list-style-type: none"> <li>✓✓ Caters perfectly well for internal management under either Option 1A or 1B.</li> </ul>  | <ul style="list-style-type: none"> <li>For participating administering authorities who are seeking a route to market without being FCA authorised, this may not work for internal investment management unless significant constraints are placed on that function. Alternatively, could be used in conjunction with an FCA regulated investment management entity.</li> </ul> |
| <b>Employment issues</b>       | <ul style="list-style-type: none"> <li>Consideration would need to be given to staff transfers, particularly to an FCA regulated operator (under Option 1A) or to an FCA regulated investment management entity (under Option 1B).</li> </ul>   | <ul style="list-style-type: none"> <li>There could be complex employment arrangements, particularly if shared services and secondments are used. Consideration would also need to be given to staff transfers, particularly to an FCA regulated investment management entity.</li> </ul>   |
| <b>Procurement issues</b>      | <ul style="list-style-type: none"> <li>There are certain contracts that will need to be procured, and these should be factored into the timeline. Where an FCA regulated investment management entity is used under Option 1B, it may not be a Teckal company so that procurement considerations will arise.</li> </ul> | <ul style="list-style-type: none"> <li>In general, the current procurement position on award of contracts would continue.</li> </ul>   |
| <b>Longevity of solution</b>   | <ul style="list-style-type: none"> <li>✓✓ The most robust solution for the long-term.</li> </ul>  | <ul style="list-style-type: none"> <li>✓ May have its limitations over the long-term, particularly in building out internal investment management (without using an FCA regulated investment management entity). Operational issues may also arise.</li> </ul>   |

## Stop Press – DCLG 24<sup>th</sup> March



The key challenge for the LGPS Central pool, as for most pools, is the development of clear and effective governance which provides the assurance authorities, beneficiaries, and co-investors require. In my view the structure, standards and systems required for an entity regulated by the Financial Conduct Authority provide substantial assurance, but I know that you are exploring a range of possibilities. As a minimum, I expect to see a single entity at the heart of any proposal, with responsibility for selecting and contracting with managers, as well as the employment of staff. There should also be a clear distinction between the roles of those involved in the governance of the pool, and its operations.

# Recommendation - CIV



- Only the CIV approach truly meets the Government's criteria:
  - for a clear and absolute separation of strategic asset allocation and implementation.
  - making the most of the benefits of scale as implementation of the investment strategy is undertaken by a single legal entity
  - that selection of external fund managers and the implementation of the investment strategy to be carried out at the pooled level
- It provides the strongest and most sustainable governance structure in the short and long term
- It provides the structure for the pool to provide internal asset management (one of the key strengths of the LGPS Central proposal)
- It provides the most tax efficient solution
- It removes the significant regulatory risks attached to a structure designed to fall outside to the scope of FCA regulation. It is important to note that if a CAP structure was chosen and the pool was 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.

# Next Steps



- Develop proposal for July based on regulated entity
- Key decisions/tasks
  - Build (option 1a) or rent (option 1b) an operator
  - Design structure of sub funds
  - Governance arrangements
  - Shareholder agreement
  - Cost/Benefit analysis
  - Transition Plan
  - What stays outside pool?





## Next Steps

- Specification for Advice/support for build / rent options appraisal and pool business case development
- Advice due 10<sup>th</sup> May for CIV build / rent decision
- 24th May Chairs, Vice-Chairs and Section 151 Officers event
- 28th June – Committee Update
- 4 July 2016 Chairs, Vice-Chairs and Section 151 Officers event
- 15th July submission



ANY  
QUESTIONS  
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