



LOCAL PENSION COMMITTEE – 15 FEBRUARY 2019

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

MINISTRY FOR HOUSING, COMMUNITIES AND LOCAL GOVERNMENT (MHCLG) CONSULTATION – ASSET POOLING

Purpose of the Report

1. The purpose of this report is to update the Committee on the impact of the Ministry for Housing, Communities and Local Government consultation concerning the draft statutory guidance on asset pooling.

Background

2. In the 2015 Budget Government announced its intention for Local Government Pension Schemes (LGPS) to pool investments. The stated aims were:
 - a. to deliver significantly reduced costs while maintaining overall investment performance
 - b. enable the authorities to develop the capacity and capability to become a world leader in infrastructure investment and help drive growth
3. On 1st April 2018 LGPS Central went live. This is the vehicle that the Leicestershire Pension Fund (the Fund), alongside 8 other schemes will use to pool assets.
4. MHCLG issued draft statutory guidance on asset pooling for consultation on 3rd January 2019. The consultation runs until 28 March 2019.
5. The guidance, which will have statutory force, sets out the requirements on administering authorities in relation to asset pooling.

Local Government Pensions Scheme: Draft Statutory guidance

6. The guidance is split into seven sections: Definitions, Structure and Scale, Governance, Transition of assets to the pool, Making new investments outside the pool, Infrastructure Investment and Reporting. Brief summaries of these are provided below.

Structure and scale

7. This section reiterates the aims of pooling, that all administering authorities must pool their assets and that pool members must appoint a pool company to implement their investment strategies. It also states that a pool company must be a company regulated by the Financial Conduct Authority (FCA). It also states that Pool Bodies must regularly review the provision of assets to the pool ensuring value for money

and cost transparency. Pool members should consider moving from active to passive investment where active management has not generated better net of fees performance over a reasonable period.

8. Due to the establishment of LGPS Central, the majority of requirements have been met. The expectations are that individual funds receive reports on savings achieved by the pool allowing scrutiny and challenge to ensure cost savings are being delivered. The fund is also required to regularly review the balance between active and passive management of assets.

Governance

9. Pool members through their own governance arrangements will be “responsible for effective governance and for holding pool companies and other service providers to account”. Pension committees should take a long term view of the potential benefits of pooling and should not simply seek to minimise costs in the short term.
10. The guidance confirms that the strategic asset allocation remains the responsibility of the fund, recognising the variety of liabilities and cash-flow forecasts.
11. To discharge these responsibilities a Joint Committee has been established, as the body for LGPS Central’s pool members to provide oversight of the delivery of the objectives of the pool, the delivery of client service, the delivery against the pool’s business case and to deal with common investor issues.
12. A Shareholders’ Forum has also been established, whose primary role is to oversee the operation and performance of LGPS Central Ltd, the investment management company set up by the Pool, and to represent the ownership rights and interests of the Shareholding Councils within the Pool.

Transition of Assets to the Pool

13. Assets should be transitioned over a relatively short period of time and should seek to minimise transition costs while balancing speed, cost and timing. Some existing investments may be retained by pool members on a temporary basis citing assets that need to be held to maturity for example. Direct Property assets may also be retained by pool members where these can be more effectively managed. For assets held outside the pool, pool members should regularly review these assets (at least every 3 years) to ensure the rationale for keeping the assets outside the pool is robust.
14. The consultation clarifies the ability for transition costs to be shared between pool members. This should enable cost sharing to be made in a fair manner.
15. The Fund will be required to review the rationale of keeping assets outside of the pool and whether Central can offer any management benefits. This is in line with the approach taken by the Fund to date.

Making new investments outside the pool

16. All new investments should be made through the pool from 2020 and only in very exceptional circumstances should investments be made outside the pool. Exceptions are allowed in the following circumstances:

- a. local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member (max 5% of assets).
- b. Investments considered essential to delivery of the investment strategy that cannot be fulfilled by the pool. Allowed following consultation with the pool company and until the company can put a product in place

17. The Fund influences Central's product development proposals based upon its strategic asset allocation. The key areas that are unlikely to have a product developed by Central are Timberland and the Opportunity Pool. The investment strategy will need to evolve so that the Fund's objectives can still be met, albeit with a slightly different asset allocation. For example Property/Infrastructure could be suitable Timberland alternatives and co-investment or greater equity exposure could make up for the superior returns offered by the Opportunity Pool. Any exceptional circumstances will be discussed with Central and approval sought from the Investment Subcommittee or Pensions Committee in the usual way.

Infrastructure investment

18. The consultation states "there is no target for infrastructure investment for pool members or pools". Pool members may invest in their own geographical region but asset selection and allocation should be carried out by the pool.
19. Whilst MHCLG have avoided telling funds how to invest it is likely that they will continue to try and influence a greater degree of infrastructure investment. There is a stated expectation of funds moving "towards levels of infrastructure investment similar to overseas pension funds".
20. The proportion of infrastructure investments across a range of pension funds world wide range from 0% to 34% with typically most being in the 7-10% range. The Fund's infrastructure allocation is currently set at 6% and Timberland a further 3%. Hence it is likely that the Fund will reach a satisfactory level naturally.

Reporting

21. The consultation sets out a range of requirements for the annual report that covers the progress being made on pooling and comparisons between active and passive management. Funds will also be required to provide a rationale for any assets that continue to be held outside the pool. The Scheme Advisory Board will publish a consolidated report on pooling nationally.
22. The reporting requirements do not raise any immediate concerns. Not all of the factors are within our control; the most obvious being the Fund can only make pooled investments when a product is available. This is likely to be just a short term reporting issue rather than a financial problem.

Conclusion

23. The consultation is broadly in line with expectations and reinforces the Government's stated aims. A report from Hymans Robertson outlining their view on the consultation is attached as an appendix to this report; this does not highlight any

significant concerns. The Fund can only transition to the pool as quickly as there are products available, but providing a pragmatic position is taken by Central this should not be a significant issue. As a result the Fund does not intend to respond directly to the consultation.

Recommendation

24. It is recommended that the Local Pension Committee note the report.

Equality and Human Rights Implications

25. None.

Appendix

Hymans Roberston Briefing Note - Local Government Pension Scheme: Draft Statutory guidance on asset pooling.

Background Papers

26. None

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