Meeting of the Board 21st September 2015

ITEM 5 PAPER [F]

Pooled investments

Summary

1. This paper sets out the progress since the last Board meeting on the Summer Budget announcement on pooled investments. It includes the key messages which are now becoming clear; a brief note of the meetings held on the subject; and a description of the options for pooling currently under discussion.

2. The paper also includes a number of options regarding the role of the Board in responding to the budget announcement, subsequent consultations and the submission of pooling proposals.

Key messages

3. Since the budget announcement the following key messages have emerged in discussion with DCLG/HMT officials:

    a) Proposals for pooling will need to be assessed against criteria to be set by government. The budget statement is potentially misleading in that the consultation on the criteria is happening now not in the autumn.

    b) Criteria are likely to be around size (£30b has been used as an illustrative example), cost and governance. However there will be no specific savings target in the cost criteria.

    c) In the autumn the criteria will likely be published alongside a consultation on:

        - new investment regs (prudent person?); and
        - 'back stop' legislation which will apply if any fund is not invested via a vehicle/s which meet the criteria;

    d) Thoughts about pooling models and options should be underway now with a view to options going to ministers early next year.

    e) Announcement by government on the way forward likely in Spring 2016.

    f) Asset allocation is to be left at the local level, but as yet there is no guidance on the exact nature of this allocation (e.g. at the class or sub class level?)

g) Government has no fixed ideas on the structure of pools (CIV, CIF, joint procurement etc).

h) Government has no fixed ideas on type of pools (regional, multi asset or single asset) but has expressed a preference for a 'simple' solution.

i) Government is alive to the transition issues for example illiquid vehicles that cannot be unwound in the short term without significant financial penalties. It is also aware of the time that structures such as the London CIV have taken to set up. However it will probably expect pooled vehicles to be in place in this parliament even if all assets are not yet ready to be moved.

j) There may be a place for a proportion of the assets to remain under direct local control in certain circumstances. However any such exemptions would probably be for prescribed investments and will be small.

Meetings

4. Since the last Board, the following meetings have been held on this subject organised either through the Board or LGA.

5. LGA organised a fund officers/DCLG/HMT meeting on the 17th August, followed up on the 7th September to encourage thinking around the criteria and possible models. The key outputs of these meetings were that funds:

   - Remain unconvinced that there are any intrinsic benefits of scale especially for in house teams with already low costs.
   - Do not see CIVs as the only method of pooling.
   - Interpret 'asset allocation' in a number of different ways.
   - Can see some benefits to pooling in some asset classes but would want to retain some local discretion.
   - Anticipate reduced fees especially for alternatives, provided pools are well governed.

6. The LGA also organised an investment managers DCLG/HMT meeting on 24th August to solicit the views of the industry. The key outputs of this meeting were that managers:

   - Were less concerned about the background structure of any pool and more on the need for it to present itself as one client.
   - Would encourage as much decision making as possible be placed within the pools in order to achieve the greatest savings.
   - That pools if structured correctly could provide the 'sticky mandates' necessary to remove unnecessary churn.

7. The SAB held an open invitation session on 21st August for all funds. There were over 60 attendees (the vast majority officers) representing 45 funds. A copy of the Q&A from this session is attached as **ANNEX 1**

8. LGA is also assessing the demand for an elected members only session in October

Potential models

9. Making an assumption that around £30b is the target for multi asset pools with perhaps a smaller number for single asset pools which could be evidenced to operate better at the national level then a number of potential options for pooling emerge.:-

    - Six or seven[1] regional multi asset pools
    - Six or seven national multi asset pools - funds could join pools with similar investment strategies or methodologies (e.g. in-house)
    - Four or five multi asset pools (regional or national) with a single national framework for passive
    - Four or five multi asset pools with a national pool for a single asset class (e.g. infrastructure)
    - Four or five multi asset pools with single national framework for passive and a national pool for a single asset class
    - Three or four multi asset pools with single national framework for passive, a national pool for a single asset class (e.g. infrastructure) and a single pool for fixed liabilities (e.g. a pensioner pool)

10. **ANNEX 2** contains a breakdown of funds against a number of these options in particular regional, passive, single and fixed liability pools.

11. For pools themselves there are a number of different potential structures which are under consideration these being:

    - Joint procurement (e.g. the passive framework)
    - Joint vehicles (e.g. the LPFA/GMPF infrastructure pool)
    - Combined vehicles (e.g. the London CIV and Lancs/LPFA models)
    - Delegated functions (e.g. section 105 committee with lead authority)

12. For the latter two a degree of in-house management is being considered either to replicate what is already there or to build extra capacity.

13. In order for funds to be able to compare a number of these the options when considering how they would fit into proposals Hymans Robertson is currently undertaking an analysis of options with a view to assessing how each performs against the following criteria:

[1] Depending on the participation of Welsh funds in cross border pools or one Welsh pool.

- Size - are the multi asset pools sufficient to meet the assumed government criteria of £30b, are the other vehicles optimally sized for their class or method?
- Costs - what are the estimated gross savings for each option?
- Governance - how do each of the models provide political structures and behaviours that encourage best practice outcomes (e.g. long term investment)?
- Local political direction - who is working with who already, where are the obvious fits
- Central political direction - are there other policy drivers which the options best fit with (e.g. combined authorities)?
- Impact on competition - both in the manager market and between pools.
- Legislative requirements - what is needed and what would be the time frame needed?

14. The data from the above analysis will be made available to the Board and in this respect the Board Secretary will liaise with the steering group managing this work.

The role of the Board

15. The Board can contribute toward the process in a number of ways. These are outlined below and the Board are asked to endorse the actions set out in fulfilling that role.

16. Firstly the Board can continue to provide opportunities for stakeholders to meet with government in order to seek clarification on the direction of policy and present views on suitable solutions. Furthermore the Board can have a role in communicating such clarification on key aspects of the policy to stakeholders through the website, presentations at conferences and directly by letter to administering authorities.

17. Secondly the Board can provide advice both formally and informally on appropriate size ranges, cost measurement methodologies and benchmarks and best practice governance models .In this respect the **Board are asked to endorse** the following general directions of travel:

    - That the size criteria should be flexible enough to deal with multi asset, single asset and joint procurement pools while ensuring the cost benefits of scale are realised.
    - That the costs are measured on a transparent 'gross' basis and use benchmarks that reflect the differences in asset classes and risk profiles.
    - That governance requirements ensure the adoption and maintenance of best practice behaviours such as increased professionalism, longer term

mandates, lower transactional and manager churn and appropriate levels of ESG and engagement.

18. In respect of the above **Board are asked to agree** that the secretariat can commission the following work within the budget allocations to collaborative initiatives and transparency:-

    - A comparative study on the size related benefits of multi asset pools (budget allocation for VFM and collaboration £25,000)
    - Independent recommendations on a methodology for comparing gross investment costs (budget allocation £20,000)

19. Thirdly the Board can provide advice to government on the appropriate level of asset allocation to be maintained at the local level. In this respect **Board are asked to endorse** an approach which at least in the first instance maintains the choice of asset classes suitable to meet the investment beliefs, risk appetite, liability profile, need for short term income and investment returns required by funds. Asset class for this purpose could be defined at a fairly high level for example using the States of Jersey CIF model as below:-

    - UK Equities
    - Global Equities
    - Global Passive Equity
    - Short-Term Corporate Bonds
    - Long-Term Corporate Bonds
    - Short-Term Government Bonds
    - Long-Term Government Bonds
    - UK Index-Linked Gilts
    - Long-Term Cash and Cash Equivalents
    - Commodities,
    - Private Equity
    - Property
    - Infrastructure

20. Next the Board can ensure that the work streams on separation and deficits are reflected in the options being considered. For example by linking the KPMG findings into it advice on governance structures and by commissioning work on the suitability of including a fixed liability matching pool in the mix. In this respect **Board are asked to agree** that the secretariat may commence work on commissioning the latter within the budget already allocated in the deficits work plan (£15,000)

21. Next the Board can take play a part in encouraging potential groupings of funds to come together to provide a cohesive set of proposals to be presented to government in the new year thus avoiding the scenario of a myriad of

overlapping proposals many of which may not meet the government criteria . This approach **which the Board are asked to endorse** would involve:

- The identification of existing or emerging pools;
- Consultation with funds to determine those pools with suitable levels of political and professional support;
- The support (within the limits of the Board budget and resources) and promotion of those pools;
- Engagement with non-committed funds to encourage their participation in or agreement to using those pools;
- Potentially leading to a proposal to government from the Board including a limited number of pooling options with the support of the majority if not all funds.

22. Finally the Board can choose act as a direct facilitator of one or more of the elements within a supported option. For example by providing the structure and resources necessary to host a passive framework. In this respect **the Board are asked to agree** that an offer in principle can be made to funds to act as such a facilitator.

Board secretariat
15th September 2015