Investment and Engagement Sub-Committee

ITEM 3 18th January 2016

Pooling criteria and timing

Government publishes guidance on asset pools

Criteria

1. Asset pool(s) that achieve the benefits of scale: The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least **£25bn** of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported. Authorities should explain:

    - The size of their pool(s) once fully operational.
    - In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
    - The type of pool(s) they are participating in, including the legal structure if relevant.
    - How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
    - The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

2. Strong governance and decision making: The proposed governance structure for the pools should:

    I. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
    II. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

    Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability. Authorities should explain:

    - The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.

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Investment and Engagement Sub-Committee

- The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- Decision making procedures at all stages of investment, and the rationale underpinning this.
- The shared objectives for the pool(s), and any policies that are to be agreed between participants.
- The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
- How any environmental, social and corporate governance policies will be handled by the pool(s).
- How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

3. Reduced costs and excellent value for money: In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so are rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.

   Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

   As part of their proposals, authorities should provide:

   - A fully transparent assessment of investment costs and fees as at 31 March 2013.
   - A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
   - A detailed estimate of savings over the next 15 years.

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- A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
- A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

4. An improved capacity to invest in infrastructure: Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class. Authorities should explain:

- The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
- How they might develop or acquire the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or "fund of funds" arrangements.
- The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

Timing

5. By 19 February 2016 submissions which should include a commitment to pooling and a description of their progress towards formalising their arrangements with other authorities. Authorities can choose whether to make individual or joint submissions, or both, at this first stage.

6. By 15 July 2016, submissions which fully address the criteria in this document, and provide any further information that would be helpful in evaluating the proposals. At this second stage, the submissions should comprise:

- for each pool, a joint proposal from participating authorities setting out the pooling arrangement in detail. For example, this may cover the governance structures, decision-making processes and implementation timetable; and
- for each authority, an individual return detailing the authority's commitment to, and expectations of, the pool(s). This should include their profile of costs and savings, the transition profile for their assets, and the rationale for any assets they intend to hold outside of the pools in the long term

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7. Movement of assets is expected to take start in April 2018 and be completed ‘over a relatively short timeframe’ but it is recognised that illiquid assets will not be able to transition in that timeframe.

Exemptions

8. The guidance presumes that all assets will be pooled but provides for funds to make the case for minimal local retention where clear value for money can be demonstrated. Any such exemptions would be subject to regular review.

Current position on pools[1]

9. The secretariat is aware of the following pools either declared or close to declaring:-

Name	Number of Funds	Assets
GMPF/WYPF/MPF	3	£40b
WMPF plus 7	8	£35b
SW (project Brunel)	8-11	£19b-£26b
SE (project Access)	8	£26b
Wales*	8	£12b
Surrey/Cumbria/East Riding/Warks	4-8	£11b-£25b
LPFA/Lancs	2	£10b

*any request from Wales to be exempt from the size criteria will be subject to ministerial approval

Committee decision

10. Committee are asked note the contents of this report.

[1] NB The names, numbers and assets of funds may not reflect the proposed and agreed pools.