Appendix A

This matter is being dealt with by:
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Nottinghamshire County Council

LGPS Reform
Department for Communities and Local Government
2/SE Quarter, Fry Building
2 Marsham Street
London
SW1P 4DF

11 February 2016

Dear Sir/Madam

Local Government Pension Scheme: Investment Reform Criteria and Guidance

Consultation on Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

Thank you for the opportunity to bring forward proposals for pooling assets within the Local Government Pension Scheme (LGPS) and to respond to the consultation on the proposed Investment Regulations.

In framing the investment reform criteria, we are pleased to see that the government has recognised a number of strengths that have been present within the Nottinghamshire Fund for many years and that we have highlighted in our previous responses on LGPS reform:

- Strong and effective governance is key to long term performance
- Local fund authorities are best placed to determine asset allocation
- Returns are enhanced by adopting a long-term, responsible investment approach
- Internal investment management is low cost and performs strongly over the long-term
- Active management can add value over the long term

A key theme to these strengths is the focus on the long-term. It is also vital that the government recognises that there will be significant costs incurred in setting up the pools and resourcing them effectively and that cost savings on the scale envisaged may take a number of years to achieve.

Our Fund has been active in progressing a pool of Midlands based funds, known as LGPS Central. This collaboration will see the creation of a multi asset investment pool of around £35 billion in size that will meet all of the criteria set by government in terms of:

- Asset pools that achieve the benefits of scale
- Strong governance and decision making
- Reduced costs and excellent value for money
- An improved capacity to invest in infrastructure

A joint submission has been agreed by all the LGPS Central participating funds and this is attached as our response.

Also attached is our response to the consultation on the revised investment regulations. The Nottinghamshire Fund has always taken a prudent approach to its investments and this will not change under the proposed new regulations. In terms of the new powers of intervention, it is vital that measures are put in place to ensure that these are justified and proportionate in all cases. It is hoped that the wealth of published information available on the LGPS is used as evidence to support intervention and that appropriate expert advice is sought by the Secretary of State.

There is a huge amount of work to do to prepare for the detailed submissions in July and then to implement the new asset pool. We look forward to working with the government through this period to ensure the long term sustainability of the LGPS in continuing to provide decent, affordable pensions to the thousands of members within the scheme.

Yours faithfully,

Cllr Reg Adair
Chairman
Nottinghamshire Pension Fund Committee

Cllr Mike Pringle
Vice-Chairman
Nottinghamshire Pension Fund Committee

Joint submission to government in response to the DCLG issue of *Local Government Pension Scheme: Investment Reform Criteria and Guidance*

5 February 2016

In the July Budget 2015, the government announced its intention to work with Local Government Pension Scheme (LGPS) administering authorities to ensure that they pool investments to significantly reduce costs while maintaining overall investment performance. In November 2015, the government published *Local Government Pension Scheme: Investment Reform Criteria and Guidance* which asked for submissions from funds on their proposals to meet the four specified criteria.

Initial submissions should include a commitment to pooling and a description of progress towards formalising arrangements with other authorities. This is a joint submission on behalf of LGPS Central, a collaboration of nine LGPS Funds, all based in the Midlands, who are working together to create an investment pool of around £35 billion.

The following funds have committed to be involved in the creation of LGPS Central:

- Cheshire Pension Fund
- Derbyshire County Council Pension Fund
- Leicestershire County Council Pension Fund
- Nottinghamshire County Council Pension Fund
- Shropshire County Pension Fund
- Staffordshire Pension Fund
- West Midlands Pension Fund
- West Midlands ITA Pension Fund
- Worcestershire County Council Pension Fund

Six of the funds involved have already collaborated on a joint procurement exercise, realising significant savings on passive investment fees. This demonstrates the ability to work together and achieve agreement through open and constructive discussion. This approach forms a firm basis for the creation of LGPS Central.

Officers of the participating funds have been meeting regularly since November 2015 and are continuing to meet on a fortnightly basis to ensure the tight timescales for establishment of the pool are met. An event was held in January 2016 for the Chairs, Vice-Chairs and chief finance officers of each participating fund to meet and talk through progress to date and how it is envisaged that the pool will meet the criteria set by government.

A. Asset pool(s) that achieve the benefits of scale

The collaboration will see the creation of a multi asset investment pool of around £35 billion in size, meeting the scale sought by the Government in its investment pooling criteria. It is expected that all investment will be made through the pool over time although the transition period for illiquid assets will extend beyond 2018. Participating funds will consider if they propose to hold assets outside the pool where this can demonstrate clear value for money. Any assets that are held outside of the pool will be kept under review.

The pool will aim to deliver cost savings and to build on the individual participating funds' strong investment knowledge and performance by providing scale, increased resilience and knowledge sharing. The new investment pool will offer access to both internal and external investment expertise.

B. Strong governance and decision making

The pool will ensure robust governance and decision making arrangements with equal say in the oversight of the new entity to each participating Fund. Preliminary investigations have been made into the process and possible structures for the pool and discussions are being held with the other emerging pools on procuring joint external advice. At this stage, no decision has been made over the structure but options being considered include:

- A joint committee
- FCA regulated operating company overseeing pooled vehicles including authorised contractual schemes (ACS), unit trusts and limited partnerships

The final structure will ensure a clear link between the pool and the governance structures in each participating fund. Decisions over investment strategy and strategic asset allocation will remain with individual funds.

A "Statement of Commitment" has been agreed to outline the key characteristics and investment beliefs of the pool, and this is attached below. A detailed work plan is being formulated to determine the structure of the pool, the internal and external resources required and the timescales for establishing the pool and moving assets.

C. Reduced costs and excellent value for money

The pool has already begun to collate data on costs incurred by participating funds for years ending 31 March 2013 and 31 March 2015. This is being collected on a consistent basis and will be analysed to inform the detailed submissions required in July. The pool is expected to generate savings over the long term but implementation and transition costs are likely to be significant.

The size of the pool will enable significant savings to be made on external management fees. A number of participating funds have internal investment expertise which is recognised to be relatively low cost and it will be difficult for these funds to achieve cost savings. However, additional savings will be realised through stronger procurement of supporting services and the building and sharing of expertise across funds, particularly in alternative asset classes.

The pool intends to work collaboratively with the Local Government Pension Scheme more widely and with the other emerging pools. Procurement will be undertaken where possible through the LGPS National Frameworks, other approved frameworks or jointly with other LGPS pools.

D. An improved capacity to invest in infrastructure

Consideration will be given to participating funds' current asset allocation and the best ways to access all asset classes including infrastructure. It is recognised that infrastructure has a role to play for many LGPS funds given their long term liabilities and the nature of returns from infrastructure. Analysis of participating funds' current allocations to infrastructure shows that LGPS Central already has a higher than average allocation to the asset class and that this has increased substantially since 2013. Funds also invest in infrastructure assets (in areas such as energy, utilities, logistics and housing) through their allocations to property, bonds and listed equities.

Participating funds within LGPS Central have different funding levels and deficit recovery profiles and so have differing risk appetites and return requirements from infrastructure. It is expected that an LGPS infrastructure platform will be set up that will allow all LGPS funds to access the asset class in a manner that is low-cost and also allows individual funds to match their required risk/return profiles. LGPS Central will ensure that appropriate cost-effective ways of accessing infrastructure are available, which may include building on internal expertise.

LGPS Central

STATEMENT OF COMMITMENT

LGPS Central is investigating the opportunities for investment collaboration between like-minded Local Government Pension Scheme funds against the background of the government's proposals for pooling LGPS investments. The Group has a regional identity but collaboration with other LGPS pools will be welcomed. **One fund**, **one vote**, will be an overriding principle of any resulting pooling arrangement. Recognising that Funds have different funding levels and deficit recovery profiles; the pool's structure will aim to meet the Funds' needs in this respect.

Characteristics

- Assets will be managed by both internal and external investment managers
- The split between internal and external management will vary over time
- The internal investment resource and resilience will be developed where appropriate
- Knowledge and expertise will be shared
- Participants will be open to challenge and change
- Participants will listen and be constructive
- Strong governance, based on openness and transparency, within the pool will be paramount
- Costs will be actively managed and transparent, and will be shared fairly between participants
- Responsible investment will be an integral part of the investment process
- Collaboration with other LGPS pools will be encouraged

Investment Beliefs

- A long term approach to investment will deliver better returns
- The long term nature of LGPS liabilities allows for a long term investment horizon
- Asset allocation is the most important factor in driving long term investment returns
- Liabilities influence the asset structure; funds exist to meet their obligations
- Risk premiums exist for certain investments and this can help to recover funding deficits
- Markets can be inefficient; therefore there is a place for both active and passive management
- Diversification across investments with low correlation improves the risk/return profile
- Secure and growing income streams underpin the ability to meet future liabilities
- Responsible investment can enhance long term investment performance

Measurement of Success

- Successful delivery of the pool against the government's published criteria

5 February 2016

Nottinghamshire County Council

Response to *Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009*

1. Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?
The Nottinghamshire Fund has always taken a prudent approach to its investments, seeking appropriate advice from officers and independent advisers. The Fund has an approved Risk Management Strategy and Risk Register and manages the investment risk by ensuring an adequate number of suitably qualified investment managers and by requiring managers to hold a diversified spread of assets. This will continue to work well within a "prudential" approach to investment.
2. Are there any specific issues that should be reinstated? Please explain why.
No
3. Is six months the appropriate period for the transitional arrangements to remain in place?
Six months is appropriate.
4. Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?
One of the concerns over the existing regulations is that they are not clear. The new regulations should therefore be explicit. Derivatives are currently used by some of the Fund's investment managers for purposes other than risk management.
5. Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?
There is a wealth of published information available on the LGPS and individual funds and this should provide sufficient evidence to support a belief that intervention may be required. It should be expected that, where intervention is being considered, funds are contacted in advance of a final decision to intervene in order to present additional evidence or justification for their position.
6. Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?
The timescale for authorities to respond is unclear. A period of 3 to 6 months would be appropriate.

7. Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?
The proposals give sufficient flexibility. It is hoped that appropriate expert advice is sought by the Secretary of State in all cases of intervention to ensure that it is justified and proportionate.
8. Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?
If the Secretary of State seeks appropriate expert advice in all cases of intervention (as stated at question 7) then the proposals meet the policy objectives.