

21 June 2016**Agenda Item:****REPORT OF SERVICE DIRECTOR – FINANCE, PROCUREMENT &
IMPROVEMENT****LGPS CENTRAL BUSINESS CASE****Purpose of the Report**

1. To provide an update on progress regarding the pooling of investments in the Local Government Pension Scheme (LGPS). To ratify the decisions to use an FCA regulated authorised structure for the LGPS Central investment pool and to create/build an operator. To agree the business case for the LGPS Central investment pool for the DCLG submission on investment pooling required by 15 July 2016.

Information and Advice

2. At its meeting on 15 March 2016, this Committee was notified of the Fund's initial response to the government's request for proposals on asset pooling including the creation of a multi asset investment pool called LGPS Central expected to be some £34 billion in size. This report brings the business case for LGPS Central which will form the basis of the detailed submission to government due by 15 July 2016. The Committee's Chair and Vice-Chair and the Council's s151 Officer have been kept informed throughout the discussions on the business case.
3. Some information relating to this report is not for publication by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972. Having regard to the circumstances, on balance the public interest in disclosing the information does not outweigh the reason for exemption because divulging the information would significantly damage the Council's commercial position in relation to the Pension Fund. The exempt information is set out in the attached exempt appendix.

Recommended legal structures and governance arrangements

4. In order to meet the Government's criterion for strong governance, legal and governance structures need to be put into place that are suitably robust. There are two realistic options, both put forward in the Project Pool submission made by LGPS funds and facilitated by Hymans Robertson.
5. The option agreed unanimously by the funds participating in the LGPS Central investment pool is that an FCA regulated authorised structure should be used. This will involve using a collective investment vehicle (CIV) with an authorised contractual scheme (ACS) and other legal structures for assets. This option is robust, in alignment with LGPS Central's requirements and with the Government's criteria. At meetings with officials from the Department for Communities and Local Government (DCLG), the Treasury and the Local

Government Association (LGA), it was made clear that an FCA regulated structure was the Government's strong preference.

6. The other option, a collective asset pool, which has no legal status and would be overseen by a Joint Committee providing governance oversight, was considered to be insufficiently robust and unlikely to meet the Government's criteria.
7. Having agreed a corporate structure, fund officers have explored the options for establishing an operator for the LGPS Central investment pool. They have agreed that of the three available options, the build option (ie creating an operator) is strongly recommended as it is estimated to be the most cost effective for the long term and provides the most flexibility for the establishment and management of the operator. With respect to the other two options, to buy or to rent an existing operator, the former has limited availability and the latter gives less flexibility (coupled with higher long term costs).
8. The Committee is recommended to formally ratify these decisions.

Business case

9. The next stage in the process is to agree a business case for the detailed submission to DCLG. In order to produce a business case, an external adviser has been needed and following a tendering process, Deloitte was appointed for this task with support from Eversheds on the legal considerations. The business case, which is attached in the exempt appendix, rests on meeting the Government's four criteria as follows.
10. **Governance.** The FCA regulated authorised structure is expected to meet the governance criteria set by the Government. The proposed operator will be owned equally by each fund participating in the LGPS Central investment pool with one share and one vote per fund. The structures to be put in place will ensure that participating funds oversee the management of the operator (via a shareholders' forum) and that their investment management needs are also met (via a practitioners' advisory forum).
11. A draft responsible investment framework for the LGPS Central investment pool has been prepared and is attached as an annex to the business case. The framework is designed to address the Government's requirement for investment pools to address environmental, governance and social issues.
12. **Scale.** With some £34 billion of assets, the LGPS Central investment pool will meet the Government's size criterion – the expectation is for the new investment pools to have at least £25 billion of assets. Very few exceptions will be requested – one is for the West Midlands Transport Authority's fund's buy in policy (valued at £250 million) and the other is for cash held for operational, non-investment purposes, expected to be very modest in scale.
13. **Costs and cost savings.** Modelling has been done, using relatively conservative assumptions around transition costs and fee reductions, on costs and cost savings for the LGPS Central investment pool over the fifteen year period to 31 March 2034. The base case projection is that annual investment costs then will be £152 million after operator running costs, compared with £196 million in 2014/15, representing an annual cost saving of £44 million by then. Cumulative savings for the LGPS Central investment pool are estimated at £262 million by 31 March 2034, with break-even expected by 31 March 2026.

14. Cost savings will be secured through economies of scale and mandate rationalisation, fee negotiations and more use of direct (rather than more expensive indirect) investment. The LGPS Central investment pool will deploy both internal and external investment management. The base case for cost savings assumes that the current mix of internal and external investment management remains but the savings are projected to be higher with greater use of internal management.
15. The set up costs for the LGPS Central investment pool are estimated to be between £3 million and £4 million with Nottinghamshire's share estimated at between £0.4 million and £0.5 million. Once set up, annual operator costs are projected to be around £5.2 million. Transition costs are estimated to be significant – one off costs of £50 million are projected across the pool.
16. In Nottinghamshire's case specifically, annual cost savings are estimated to be £685,000 per annum in 2033/34 compared with 2014/15. The cost savings assume no changes in asset allocation or fund size and have been struck after operator running costs. More savings could be secured through the greater use of internal management (up to £2.7 million annual savings by 2033/34).
17. **Infrastructure.** One of the Government's criteria is to encourage more investment in infrastructure. The strategic decision to invest in the asset class will remain with administering authorities, with implementation resting with the new investment pools, including LGPS Central.
18. National infrastructure platform options are currently being explored by the LGPS, including LGPS Central, in order to enable better access to suitable opportunities in the UK. A national infrastructure platform will lead to lower fees and should enable better diversification.
19. The current weighted target allocation to infrastructure for the LGPS Central investment pool is 4%, with 1.5% actually invested. The target is expected to rise to over 5% in the coming years. In the case of Nottinghamshire, the target allocation to infrastructure is 5%, with 1% actually invested.
20. The Committee is recommended to agree the business case.

Programme planning and timing

21. Once all of the funds participating in the LGPS Central investment pool have approved the business case, there will be a meeting of Committee Chairs, Vice-Chairs and Section 151 Officers on 8 July 2016 at which it will be ratified. A copy of the draft resolution to be signed by each participating fund is attached in an annex to the business case. The business case will be submitted to the DCLG for its approval by no later than 15 July 2016.
22. It is planned that the operator will be incubated in October 2016 and a shareholders' agreement will need to be signed in advance of that. Pending that, a memorandum of understanding has been agreed between the participating funds and this is attached as an annex to the business case.
23. Key executives will need to be appointed by no later than April 2017, ahead of the application for FCA registration. This will ensure that the LGPS Central investment pool will be set up by no later than 1 April 2018.

Resourcing

24. A substantial amount of work will be required for the LGPS Central investment pool to be set up properly. Each participating fund is devoting resources to the workstreams supporting the business case.
25. In order to incubate the operator and determine key objectives in the coming months, external advisers will need to be procured by the end of July 2016, to provide advice on the operational, business, accounting, legal and taxation issues associated with setting up the LGPS Central investment pool. Headhunters will need to be appointed so that a Chief Executive and Chief Operating Officer are in place by April 2017. These appointments will be needed by then so that FCA registration can take place and it will be important too that fit for purpose IT systems are put in place in advance of the set up date of 1 April 2018.

Communications

26. It is planned that monthly briefing notes will be circulated to Committee members in order to keep them informed of the progress in setting up the LGPS Central investment pool.
27. A weblink enabling Committee members to access documentation on the LGPS Central investment pool will be set up shortly - details of how to access the weblink will be circulated in the near future.
28. A communications policy and strategy for the LGPS Central investment pool are attached as annexes to the business case.

Reason/s for Recommendation/s

29. In July 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 Department for Communities and Local Government (DCLG) published *Local Government Pension Scheme: Investment Reform Criteria and Guidance* and asked for refined and completed submissions by 15 July 2016, which fully address the criteria from DCLG. The recommendations are intended to ensure that an acceptable submission is made by the required deadline.
30. Under the terms of the Council's constitution, the Nottinghamshire Pension Fund Committee is responsible for all decisions in relation to administering the Nottinghamshire Pension Fund, including investments by and management of pension funds. This report makes recommendations regarding the investments of the Fund.

Statutory and Policy Implications

31. This report has been compiled after consideration of implications in respect of crime and disorder, finance, human resources, human rights, the NHS Constitution (Public Health only), the public sector equality duty, safeguarding of children and vulnerable adults, service users, sustainability and the environment and ways of working and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

It is recommended that:

- 1) Progress regarding the pooling of investments in the LGPS be noted.
- 2) The decision to use an FCA authorised structure with an operator for it to be created and built is ratified.
- 3) The LGPS Central investment pool's business case for submission to the DCLG, including the draft responsible investment framework and other annexes, is agreed.

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Constitutional Comments (SLB 08/06/16)

32. The proposals in this report are within the remit of the Nottinghamshire Pension Fund Committee.

Financial Comments (SRC 08/06/16)

33. The financial implications to the Fund are set out in the exempt appendix.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

- 'None'