

**REPORT OF CHAIRMAN OF NOTTINGHAMSHIRE PENSION FUND
COMMITTEE****LGPS CENTRAL ASSET POOLING – GOVERNANCE ARRANGEMENTS****Purpose of the Report**

1. To make recommendations in respect of changes that will be required to the operational and governance arrangements for the Nottinghamshire Pension Fund following recent amendment of the Local Government Pension Scheme (LGPS) Investment Regulations. The revised regulations require all administering authorities in England and Wales to enter into joint (pooled) arrangements for the management of their investment assets, with effect from 1 April 2018, in order to meet criteria set by the government.

Information and Advice

2. The LGPS is one of the largest funded pension schemes in the world with combined assets of around £200 billion. These are managed by 89 local administering authorities, who historically have maintained separate arrangements for the management of scheme assets, overseen by their respective Pension Fund Committees.
3. Between them it is estimated that administering authorities incur total administrative and management costs of around £500 million per year, a significant proportion of which relates to investment management fees paid to external fund managers. Funds often use the same managers, offering the same or similar services but appointed under separate agreements and on different fee terms.
4. Funds also vary significantly in scale; large funds enjoy direct access to a wide range of investment markets and products and can often negotiate more competitive fees, whilst smaller funds have more restricted options due to lower levels of investment resources and expertise and less negotiating power in the market.
5. Over the past two and half years the government has explored a number of options for improving the efficiency and sustainability of the scheme, and has undertaken extensive consultation on the potential to deliver savings through greater collaboration. A national cost benefit exercise, co-ordinated by Hymans Robertson concluded that significant savings could be achieved through greater use of collective investment approaches, provided that certain regulatory restrictions were removed.

6. Subsequently, the government announced its intention to introduce a new regulatory framework which would facilitate collective investing and issued guidance and criteria to help administering authorities to develop proposals for pooling aimed at reducing costs and improving efficiency. Initial proposals were required by February 2016, followed by more detailed business case submissions in July 2016, with a target implementation date of 1 April 2018.
7. The new Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1 November 2016. These include the requirement to approve an Investment Strategy Statement in accordance with guidance issued by the Secretary of State and also includes the power for the Secretary of State to make a direction if satisfied that the guidance is not being followed. This power may be used where authorities fail to bring forward sufficiently ambitious proposals for asset pooling.

LGPS Central

8. Reports to the Nottinghamshire Pension Fund Committee and the Pensions Sub-Committee have informed Members of the proposal to create a multi asset investment pool called LGPS Central in conjunction with the administering authorities of Cheshire, Derbyshire, Leicestershire, Shropshire, Staffordshire, West Midlands and Worcestershire. The pool will have combined assets of around £35 billion.
9. The detailed business case for LGPS Central, agreed by the Pension Fund Committee at its meeting on 21 June 2016, demonstrated how the proposal will meet the four key assessment criteria laid down by the government:
 - Asset pool(s) that achieve the benefits of scale (>£25billion)
 - Strong governance and decision making
 - Reduced costs and value for money
 - Improved capacity and capability to invest in infrastructure
10. The business case outlined the proposed governance, oversight and management structure of the pool based on advice from Eversheds, the legal advisers appointed by the pool.
11. The structure will allow participating funds to exercise control (both individually, and collectively) over the new arrangements, not only as investors in the pooled funds, but also as shareholders of the operator company, LGPS Central Ltd.
12. Whilst assets will be managed on a pooled basis, each fund will be able to exercise their investor rights independently, although benefits of scale will be most effectively harnessed where parties work together in a co-ordinated way to align their decision making. An important example of this is responsible investment and voting policies where cross-voting between funds within the same pool would be both costly to administer and counter-productive.
13. The Shareholders Forum, governed by a Shareholders Agreement and operating under company law, will have formal decision making powers. Nottinghamshire County Council will have equal voting rights alongside the other participating funds, and unanimous decisions will be required on key strategic matters. These are specified in the Shareholders Agreement and Articles of Association and include the appointment and dismissal of the company's senior executives, approval of the company's strategic plan and any significant financial transactions, such as major acquisitions, lending or borrowing.

14. The degree of control to be exercised by the Shareholders through their reserve powers will be greater than is generally the case, in order to satisfy the Teckal exemption criteria and allow the company to undertake services on behalf of the investor funds without a formal procurement process.
15. The Joint Committee, established by an Inter-Authority Agreement which includes terms of reference, will be the forum for dealing with common investor issues, and for collective monitoring of the performance of the pool against the agreed objectives of LGPS Central. It will however, have no formal decision making powers and recommendations will require the approval of individual authorities, in accordance with their local constitutional arrangements. The role of the Joint Committee will be reviewed after an appropriate period of operation.
16. The government has made clear their expectation that pooled entities should be regulated by the Financial Conduct Authority (FCA) to ensure appropriate safeguards over the management of client monies. As such, LGPS Central Ltd will be subject to on-going oversight by the FCA and key management positions, including the company directors, will need to be 'approved persons', able to demonstrate appropriate knowledge, expertise and track record in investment management. These positions also carry significant personal liability for their actions and decisions.
17. The relative merits of buying or renting an established operator to manage the day to day running of the pool have been carefully considered against the benefits of setting up a jointly owned company with associated shareholder rights. The constituent funds unanimously agreed that the latter option, whilst more expensive in the short term, offers significant advantages in terms of greater flexibility and control, as well as longer term cost savings, and this is the basis upon which the business case has been developed.
18. Staff who are currently employed by the participating Funds to manage their investments are likely to transfer under the Transfer of Undertakings (Protection of Employment) regulations (TUPE) to the new company. The implications for Nottinghamshire County Council staff will be considered as part of the overall project.
19. The detailed business case has been reviewed by a joint DCLG/HM Treasury Review Panel, and Ministerial consent to proceed has been received.
20. Comprehensive programme governance arrangements are in place to ensure that the statutory deadline for the implementation of pooling is achieved and that costs and savings are managed in accordance with the agreed business case. The s151 officers of each of the participating funds sit on the LGPS Central Programme Board and regular joint meetings are held between the Chairs and Vice-Chairs of the respective Pension Fund Committees to ensure effective member oversight of progress and delivery. The Nottinghamshire Pension Fund Committee, the Pensions Sub-Committee and the Local Pensions Board are also being updated regularly on key developments and decisions.
21. Expert advisers have been appointed to provide support on legal matters, FCA registration, taxation and overall programme management. Professional recruitment consultants have been appointed to assist and advise on executive recruitment and remuneration.

22. Eversheds provided initial drafts of the Shareholders Agreement, Articles of Association and Inter-Authority Agreement (the various agreements that are needed to establish LGPS Central and to ensure appropriate governance arrangements are in place) and these have been reviewed by Browne Jacobson on behalf of all the participating funds. After a number of iterations the final draft documents were presented to a joint meeting of Chairs, Vice-Chairs and s151 officers on 4 November 2016. Comments made at this meeting have been incorporated to produce the final versions. It is intended that these agreements are approved by each participating authority in early 2017 in accordance with the programme timeline.

Impact on the role of the Nottinghamshire Pension Fund Committee

23. The terms of reference for the Nottinghamshire Pension Fund Committee and its Sub-Committees are within the Council's constitution. A large part of the role of the Committees will be unaffected by the implementation of pooling and the creation of LGPS Central. The Committees will continue to be responsible for monitoring the overall management, performance and administration of the fund, and for setting investment strategy, including the overall allocation of assets, which is the critical factor in determining investment performance.
24. Importantly, they will also continue to be responsible for communicating with individual scheme members, whose benefits are guaranteed in law, and are therefore not affected by the new pooling arrangements or investment performance.
25. Responsibility for appointing investment managers and overseeing their performance, including any decision to dismiss, will however transfer to the pool, as will tactical decisions on the implementation of the overall investment strategy and the choice of specific investment vehicles.
26. The role of the Investment Sub-Committee will therefore be more fundamentally impacted by the pooling proposals, as its remit is focussed specifically on the review of investment manager performance. The roles of the various Committees will be reviewed in light of the new asset pool. It should be noted that the transition of assets into the pool is likely to be phased over a number of years and the Committees will have an important role in the interim in making sure that good governance is maintained over both transferred and non-transferred assets.

Other Options Considered

27. The requirement to pool assets is set out in the LGPS governing regulations and the Secretary of State has power to intervene in the Fund's investment strategy if guidance on pooling is not followed.
28. Advice was received on the options for the structure of the pool and this recommended the creation of an operating company authorised and regulated by the FCA. This is also the government's preferred option. Other potential structures were rejected on the basis of the advice and also because of the risk of possible criminal liability resulting from operating an unregulated collective investment scheme.
29. The option to buy or rent an operator for the pool was considered but rejected as it would be more costly in the medium to long term and gives less control and flexibility over the set up and ongoing operations.

Reason/s for Recommendation/s

30. The recommendations will allow the Council to comply with updated LGPS Investment Regulations which came into effect in November 2016, requiring all administering authorities to commit to an investment pooling arrangement which meets the criteria and guidance laid down by the Secretary of State in November 2015. Where authorities fail to comply with the criteria and guidance, the Secretary of State has powers to intervene, and to issue a Direction requiring changes to investment strategies and investment management arrangements, or the transfer of the investment functions of an administering authority, either to himself or a nominated party.
31. The proposal to establish LGPS Central is supported by a comprehensive business case, which demonstrates the potential for significant savings in investment costs and management fees over the longer term, without detriment to investment performance and local accountability.

Statutory and Policy Implications

32. 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 Council approve the following:

- a) To enter into joint agreements with Cheshire West and Chester Council, Derbyshire County Council, Leicestershire County Council, Shropshire Council, Staffordshire County Council, Wolverhampton City Council and Worcestershire County Council to establish a joint pension fund investment pool and to establish a Joint Committee under s102 of the Local Government Act 1972.
- b) To become a joint shareholder of LGPS Central Ltd, incorporated for investment management purposes and regulated under the Financial Services and Markets Act 2000.
- c) To appoint the Chairman of the Nottinghamshire Pension Fund Committee, or his nominated representative, to act as the Council's representative on the Joint Committee and Shareholders Forum and to exercise the Council's voting rights as a shareholder of LGPS Central Ltd.
- d) To appoint the Service Director (Finance, Procurement & Improvement) to represent the Council on a Practitioners Advisory Forum.
- e) To authorise the Corporate Director Resources to enter into all necessary legal agreements to establish a joint asset pool and investment management company as outlined in this report, after consultation with:
 - Chairman and Vice-Chairman of the Pension Fund Committee;

- Service Director (Finance, Procurement & Improvement); and
- Group Manager for Legal Services.

Councillor Reg Adair
Chairman of Nottinghamshire Pension Fund Committee

For any enquiries about this report please contact:
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Constitutional Comments (SLB 29/12/16)

33. County Council is the appropriate body to consider the content of this report.

Financial Comments (SRC 29/12/16)

34. Costs associated with the set up and operation of the asset pool will be recharged to the pension fund in accordance with governing regulations.

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.

Reports to Nottinghamshire Pension Fund Committee

6 December 2016 – LGPS CENTRAL GOVERNANCE ARRANGEMENTS (Published)

21 June 2016 – LGPS CENTRAL BUSINESS CASE (Published)

15 March 2016 – ASSET POOLING AND CONSULTATION ON REVISED INVESTMENT REGULATIONS (Published)

8 September 2015 – LOCAL GOVERNMENT PENSION SCHEME POOLED INVESTMENTS (Published)

Reports to Pensions Sub-Committee

10 November 2016 – LGPS CENTRAL ASSET POOL (Published)

14 July 2016 – LGPS CENTRAL SUBMISSION (Published)

5 May 2016 – LGPS ASSET POOLING (Published)

4 February 2016 – ASSET POOLING AND CONSULTATION ON REVISED INVESTMENT REGULATIONS (Published)

Electoral Division(s) and Member(s) Affected

- All