



**REPORT OF SERVICE DIRECTOR – FINANCE, PROCUREMENT &
IMPROVEMENT**

LGPS CENTRAL ASSET POOL

Purpose of the Report

1. To provide an update on progress regarding the pooling of investments in the Local Government Pension Scheme (LGPS).

Information and Advice

2. 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 Department for Communities and Local Government (DCLG) published *Local Government Pension Scheme: Investment Reform Criteria and Guidance*. The criteria cover the following:
 - A. Asset pool(s) that achieve the benefits of scale
 - B. Strong governance and decision making
 - C. Reduced costs and excellent value for money
 - D. An improved capacity to invest in infrastructure
3. Authorities were asked to submit their initial proposals on asset pooling to the Government by 19 February 2016 with refined and completed submissions by 15 July 2016. At the Pension Board meeting on 19 April 2016, Board members were notified of the Fund's initial response to the government's request including the creation of a multi asset investment pool called LGPS Central, expected to be some £34 billion in size.
4. At its meeting on 21 June 2016, the Nottinghamshire Pension Fund Committee approved the business case for the LGPS Central investment pool and this formed the basis of the detailed submission to government. This report provides an overview of the business case and progress towards the creation of LGPS Central. The Pension Fund Committee and the Pensions Sub-Committee, along with the Committee Chair and Vice-Chair and the Council's s151 Officer have been kept informed throughout the discussions on the business case.

Recommended legal structures and governance arrangements

5. 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.
6. The option agreed unanimously by the funds participating in the LGPS Central investment pool is that a Financial Conduct Authority (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 has been made clear that an FCA regulated structure is the Government's strong preference.

7. 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.
8. Having agreed a corporate structure, fund officers explored the options for establishing an operator for the LGPS Central investment pool. They 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).

Business case

9. In order to produce the business case, external advisers (Deloitte and Eversheds) were appointed following a tendering process. The business case 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. The framework is designed to meet 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 1.6% actually invested.

Programme planning and resourcing

20. A joint meeting of Committee Chairs, Vice-Chairs and Section 151 Officers was held on 8 July 2016 at which the business case was ratified before being submitted to the DCLG for its approval.
21. A further tender for advisers to provide advice on the operational, business, accounting, legal and taxation issues associated with setting up the LGPS Central investment pool has been carried out and PwC and Eversheds have been appointed. Workstreams have been set up to ensure each element of the implementation is considered and detailed plans have been developed for each stream. A substantial amount of work will be required for the LGPS Central investment pool to be set up properly and each participating fund is devoting resources to the workstreams supporting the business case.
22. A draft shareholders' agreement (which will replace the memorandum of understanding already in place between the participating funds) is being considered at the first Shareholders' Forum on 27 September 2016. A target operating model is also being

developed in conjunction with PwC and this will inform the development of sub-funds within the CIV and the procurement of external support services (such as depositary and asset servicer).

23. Key executives are planned to be appointed to the operator by April 2017, ahead of the application for FCA registration. This will ensure that the LGPS Central investment pool will be set up by 1 April 2018. Additional advisers are likely to be needed for recruitment of key executives and to ensure fit for purpose IT systems are put in place.

Statutory and Policy Implications

24. 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 the report be noted.

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Constitutional Comments

25. Because this report is for noting only, no Constitutional Comments are required.

Financial Comments (SRC 26/08/16)

26. There are no direct financial implications arising from this report.

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'