

Report of the Director West Yorkshire Pension Fund to the meeting of the Local Pension Board to be held on 9 November 2016.

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Subject:**Investment Reform Criteria and Guidance – Investment Pooling****Summary statement:**

In the July Budget 2015, the Chancellor announced the Government's 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. On 25 November the Investment Reform Criteria and Guidance were issued, which sets out the criteria to be applied to the pooling of LGPS assets. Authorities were invited to submit their initial proposals for pooling by 19 February 2016. West Yorkshire Pension Fund (WYPF) together with Greater Manchester and Merseyside duly submitted its proposals by the deadline. The submission and the Minister's response are on the WYPF website. A more comprehensive proposal has been submitted to the Government on 15 July 2016. This submission will be assessed against the criteria in this document.

The Merseyside Local Pensions Board (LPB) considered pooling arrangements at its meeting in April, and requested that its resolution be considered by the Local Pension Boards of the other two members of the Northern Pool. The resolution is attached as Appendix F

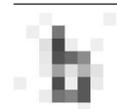
Recommendation

That the Panel:

- Note the submission, and the continued development of pooling arrangements, subject to the Government response.
- Consider the Merseyside LPB resolution

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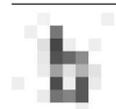


1. Background

- 1.1 In the summer Budget 2015, the Chancellor announced the intention to invite administering authorities to bring forward proposals for pooling Local Government Pension Scheme investments, to deliver significantly reduced costs while maintaining overall investment performance.
- 1.2 The Scheme is currently organised through 89 separate local government administering authorities and the closed Environment Agency scheme, which each manage and invest their assets largely independently. The Government believes that, working together, authorities have a real opportunity to realise the benefits of scale that should be available to one of Europe's largest funded pension schemes, and the creation of up to six "British Wealth Funds", each with at least £25bn of Scheme assets, will not only drive down investment costs but also enable the authorities to develop the capacity and capability to become a world leader in infrastructure investment and help drive growth.

2. Pooling Criteria

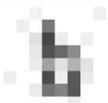
- 2.1 Authorities are to suggest how their pooling arrangements will be constituted and operate. In developing proposals, they should have regard to each of the four criteria, which are designed to be read in conjunction with the supporting guidance.
- 2.2 Asset pools should achieve the benefits of scale. 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:
 - 2.2.1 The size of their pool(s) once fully operational.
 - 2.2.2 In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
 - 2.2.3 The type of pool(s) they are participating in, including the legal structure if relevant.
 - 2.2.4 How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
 - 2.2.5 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.
- 2.3 The pools must deliver strong governance and decision making. The proposed governance structure for the pools should:



- 2.3.1 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;
- 2.3.2 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.
- 2.4 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:
 - 2.4.1 The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
 - 2.4.2 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.
 - 2.4.3 Decision making procedures at all stages of investment, and the rationale underpinning this.
 - 2.4.4 The shared objectives for the pool(s), and any policies that are to be agreed between participants.
 - 2.4.5 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.
 - 2.4.6 How any environmental, social and corporate governance policies will be handled by the pool(s).
 - 2.4.7 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.
 - 2.4.8 How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
 - 2.4.9 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.
- 2.5 Authorities are to be seeking to achieve 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.



- 2.6 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.
- 2.7 As part of their proposals, authorities should provide:
- 2.7.1 A fully transparent assessment of investment costs and fees as at 31 March 2013.
- 2.7.2 A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- 2.7.3 A detailed estimate of savings over the next 15 years.
- 2.7.4 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.
- 2.7.5 A proposal for reporting transparently against their forecast transition
- 2.8 Authorities are to be seeking to achieve 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.
- 2.9 Authorities should explain:
- 2.9.1 The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
- 2.9.2 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.
- 2.9.3 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.
- 3. Development of the Northern Pool (NP)**
- 3.1 The original NP proposals are described in the 19 February submission, which is attached to this report as Appendix C. The Minister's response is attached as Appendix D.
- 3.2 In the light of the minister's response, the revised proposals are that the NP will establish a Joint Committee, and a company will be established as an Alternative



Investment Fund Manager (AIFM), which will be approved by the Financial Conduct Authority (FCA), which will have operational responsibility for the day to day management of the investments, and appointment of external managers. The existing investment staff will work for the AIFM.

- 3.3 Individual funds will retain their current role of asset allocation and investment policy, and will delegate the implementation of that policy to the Joint Committee.
- 3.4 The Joint Committee will have responsibility for ensuring that the AIFM has the appropriate structure and resources to implement the policy required by each fund, and will hold the company to account for delivery of the policy, and performance commensurate with the agreed risk for each asset class.
- 3.5 The AIFM will be responsible for the day to day management of investments, including the internal management of quoted investments, unquoted directly held assets, such as property and infrastructure, as well as the appointment of external managers for quoted investments and other asset classes as determined by the Joint Committee.
- 3.6 The Joint Committee, which will probably consist of two Members appointed by each Fund plus a trade union representative from each fund's region, will not have any direct involvement in the appointment of managers, or any other matters delegated to the AIFM. Its role will be to determine the asset class, risk profile, and whether management is internal or external, in accordance with the investment policy set by each fund.

4. **Progress to Date**

- 4.1 The long term vision for the pool is to provide access to
 - a range of internal and externally managed listed assets at low cost
 - collective investment in alternatives, while building skill to enable cost reduction by increasing direct access
 - working arrangements with other pools where greater size may add value.
- 4.2 The investment philosophy is to maintain simple arrangements, with a relatively low number of managers, low manager and portfolio turnover, an increasing proportion of assets managed internally within the pool, while individual funds will retain the ability to select asset class, territory, and active or passive management.
- 4.3 Officers of the three funds have been meeting weekly to develop the submission (Appendix A) and have had regular briefings for senior Members of each Fund. Further legal and financial advice has been obtained to support the NP in meeting the criteria and minimising costs. The executive summary of the PWC report is attached as Appendix B.
- 4.4 As part of the preparation for NP, WYPF and Merseyside Pension Fund have approved a commitment in principle to committing £250m each to the GMPF & LPFA Infrastructure LLP (GLIL). GLIL is a joint venture between the Greater Manchester Pension Fund (GMPF) and London Pensions Fund Authority (LPFA) focused on UK



infrastructure assets. The Partnership was formed in April 2015 as a limited liability partnership (LLP) and seeded with £500m of commitments from the two pension funds. GLIL's investment committee is made up of members from each funds' investment teams. This may form part of a national solution to increasing commitments to infrastructure.

- 4.5 To date GLIL have completed two investments: a £60m investment in renewable energy (October 2015) and a £150m investment into one of Europe's largest wind farms (March 2016).
- 4.6 It is therefore recommended that the IAP approve this in principle and that due diligence is undertaken as usual for such commitments.

5. **Issues for WYPF**

- 5.1 The principle issue for WYPF in any pooling arrangement is going to be the ability to maintain our very low cost base. To achieve this we must ensure that any arrangement we enter maintains the very high standard of governance that has been exercised over the fund for many years, and the commitment to internal management, which has delivered consistent outperformance over many years at an exceptionally low cost.
- 5.2 If we are compelled to go down the regulated route, which is the implication of the Minister's comments in his letter (Appendix D), there is no question that it will increase the WYPF cost base, a cost which will ultimately fall on the local Council Tax Payers. Because of these concerns, WYPF submitted another letter on 15 July (Appendix E), when the joint submission was made, making these concerns clear.
- 5.3 We believe that alongside the funds we are currently working with, we will be able to reach a satisfactory solution, and in the long term improve the result for WYPF.

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