

Report of the Director, West Yorkshire Pension Fund, to the meeting of West Yorkshire Pension Fund Pension Board to be held on 28 March 2018.

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Subject: Investment Reform Criteria and Guidance – Investment Pooling

Summary statement:

In accordance with the guidance from Government, West Yorkshire Pension Fund (WYPF) together with Greater Manchester and Merseyside are working towards the creation of an investment pool, Northern Pool (NP). In response to the proposals submitted the Minister welcomed the commitment to investment in infrastructure, and the intention for the GLIL joint venture to become regulated to allow other pools to join. The Minister has indicated that he accepts higher initial costs will be necessary which are justified by future savings.

Pools were required to provide an update on progress by the end of April. The Northern Pool challenged the need to increase costs for funds, clarifying its simpler, cheaper model, and the progress made towards creating a low cost operational pool.

The statutory guidance accompanying the Local Government Pension Scheme (Investment & Management of Funds) Regulations 2016 requires confirmation by the Administering Authority that the pooling arrangements meet the criteria set out in the November 2015 investment reform and criteria pooling guidance. This report summarises how those criteria are met by the Northern Pool.

Recommendation and Reason for Recommendation

It is recommended that the Board note the progress on pooling to date, and confirm the pooling arrangements for the Northern Pool meet the criteria set out in the November 2015 investment reform and criteria pooling guidance, in compliance with the statutory guidance to the Investment Regulations.

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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 Government requires the Local Government Pension Scheme to deliver significantly reduced investment costs while maintaining overall performance. The criteria and guidance against which pooling arrangements are to be judged were issued in November 2016. The current investment regulations are virtually silent on pooling, simply requiring the investment strategy statement to set out its approach to pooling.
- 1.3 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.
- 1.4 In its Investment Strategy Statement (ISS) to comply with the Local Government Pension Scheme (Investment & Management of Funds) Regulations 2016 the Fund's approach to pooling investments, including the use of collective investment vehicles and shared services, must be set out. The relevant paragraph of the ISS is attached to this report as Appendix A. Under the accompanying statutory guidance it (the Administering Authority) must confirm that its pooling arrangements meet the criteria (see the next paragraph).

2. **Pooling Criteria**

- 2.1 Asset pools should achieve the benefits of scale.
- 2.2 The pools must deliver strong governance and decision making.
- 2.3 Authorities are to achieve reduced costs and excellent value for money.
- 2.4 Authorities are to achieve an improved capacity to invest in infrastructure.

3. **Development of the Northern Pool (NP)**

- 3.1 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.
- 3.2 A Joint Committee will be formed which will have responsibility for ensuring the appropriate structure and resources are in place to implement the policy required by each fund.

3.3 The Joint Committee, which will probably consist of two Members appointed by each Fund plus a total of three trade union representatives, will not have any direct involvement in the appointment of managers, or selection of investments. These matters will be fully delegated to professional officers. Its role will be to determine the asset class and risk profile, as well as 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, with individual funds retaining the ability to select asset class, territory, and active or passive management.

4.3 As part of the preparation for NP, WYPF and Merseyside Pension Fund have approved commitments to GLIL, in the case of WYPF £250m. GLIL is a joint venture between the West Yorkshire Pension Fund (WYPF) together with Greater Manchester, Merseyside and LPP (a partnership between the Lancashire Pension Fund and the London Pension Fund Authority) focused on UK infrastructure assets. 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.

4.4 A meeting was held in March with the advisors to all three funds and the NP present to consider options for developing the pool. The unanimously supported conclusion was to stick to our original plans for a simple, low cost pool that will continue delivering the performance the funds expect.

4.5 The progress report to DCLG submitted at the end of April, set out the plans for the joint committee, the appointment of a joint custodian, and the savings achieved by working together for the last year, particularly on infrastructure investment, and challenged the Minister's assertion that increasing costs would be a sensible start to pooling arrangements.

4.6 Subsequent to the April progress report DCLG requested a telephone meeting to discuss the submission. The civil servant responsible was positive on its content, and in particular welcomed:

- the commitment of the NP to infrastructure investment, the establishment of the GLIL vehicle, and our intention to make it available to other pools in the near future
- The plans to create a similar structure for private equity, where all three funds have experience, again to be made accessible to other pools and funds.

- 4.7 A further progress report was submitted in the autumn, from which there has been limited feedback to date.
- 4.8 The main workstreams for the Northern Pool are set out below and these are progressing well.
- Developing a vehicle to make private equity investments on a collective basis. The governance of this vehicle is expected to operate in a similar manner to the GLIL infrastructure vehicle.
 - Procurement of a FCA regulated custodian for the pool. A review of how the pool can develop its risk, cost and performance reporting will be undertaken alongside the procurement.
 - Work is underway to procure an FCA regulated operator for the GLIL infrastructure vehicle. This would allow other pools to join. GLIL currently has commitment of £1.3bn to direct infrastructure in the UK, with investments of almost £300m made to date. There is currently little evidence of other pools having made significant progress on developing the capacity for direct infrastructure investment.
 - The Terms of Reference for the Pool Joint Committee have been drafted, with Tameside MBC acting as lead authority. The Joint Committee will oversee the Pool and provide a democratic link back to the individual funds. The first draft is attached as Appendix 1 to this report. Any comments should be submitted to the Director as soon as possible, as this must be progressed through all three Administering Authorities' constitutional process by 1 April 2017.
- 4.9 The next significant milestone will be the appointment of the FCA regulated Pool Custodian, which will be ahead of the 1 April 2018 deadline, after which the plan is that all appropriate WYPF assets will be transferred by August 2018.

5. Meeting the Four Criteria

- 5.1 Asset pools should achieve the benefits of scale.
The total of the three funds is well in excess of the £25 billion set in the criteria, presently in the region of £40 billion.
- 5.2 The pools must deliver strong governance and decision making.
The governance arrangements set out above and in the ISS at Appendix A ensure the existing high standards of governance will be perpetuated in the new structures, and full accountability to the administering authority will be maintained.
- 5.3 Authorities are to achieve reduced costs and excellent value for money.
As set out in the original submission the Northern Pool will achieve reduced costs in the alternative asset classes through pooling activities, and will look to make savings in other areas in the future, but as the three funds already achieve excellent value for money, particularly in the case of West Yorkshire Pension Fund, there are few short term opportunities for further savings.
- 5.4 Authorities are to achieve an improved capacity to invest in infrastructure.
The Northern Pool has established GLIL for this very purpose, and GLIL will soon become a regulated vehicle which will enable it to admit other investors further increasing capacity to invest in infrastructure

6. **Issues for WYPF**

- 6.1 The principal issue for WYPF in any pooling arrangement remains 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. Research shows that large Funds tend to have lower costs because of higher level of internal management.
- 6.2 If we are compelled to go down the regulated route preferred by Treasury there is no question that it will increase the WYPF cost base, a cost which will ultimately fall on the local Council Tax Payers. The agreed strategy for the NP is to minimise costs at every opportunity.
- 6.3 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.