



By email

Teresa Clay
Ministry of Housing, Communities and
Local Government
Fry Building
2 Marsham Street
London, SW1P 4DF

22 October 2018

Dear Ms Clay,

LOCAL GOVERNMENT PENSION SCHEME POOLING: AUTUMN 2018 PROGRESS REPORT

Thank you for your letter of the 26 July 2018, and your positive feedback.

I hope the information set out in this letter and the Northern Pool's progress update to 30 September 2018, which we are pleased to enclose herewith, addresses the matters you raised.

Once again we would like to emphasise our strong support for the outcomes that the Government seeks from pooling in the LGPS, which we expect to benefit Scheme members, employers and taxpayers alike.

In order to achieve these outcomes, all pools must meet the requirements of the LGPS Investment Regulations and the Pooling Criteria and Guidance, which you issued in November 2015.

The Northern Pool has already started to deliver immediate cost savings, strengthened governance arrangements, and via its GLIL infrastructure vehicle and housebuilding finance, a significant increase in investment in UK infrastructure.

Independent benchmarking analysis, highlighted in the progress update, continues to show that the performance of the funds in the Northern Pool has been well above the LGPS average, whilst our average costs are below those of the Northern Pool's global peer group. However, as we discussed when we met in May, we remain disappointed that all LGPS funds and pools are not participating in such analysis.

Due to their existing scale and low cost, the vast majority of the benefits of pooling for the funds in the Northern Pool as we have previously advised relate to alternative assets where there is greatest scope to generate further economies of scale, and to combine resources to make increasingly direct investments. Since we met in May, the Northern Pool has:

- Established a vehicle (known as 'NPEP') to make collective private equity investments. NPEP has a General Partner/Limited Partner structure and is fully compliant with all relevant financial services regulations. NPEP is currently ahead of schedule having made 3 fund commitments totalling c£200m since its formation in July and will be making total commitments of £480m to private equity funds in 2018/19 and is expected to make commitments of £1bn by 31 March 2020.

- Increased its commitments to the GLIL Infrastructure vehicle to £1.275bn, taking the total commitments to GLIL up to £1.825bn resulting in further investment in wind farms and ports over the summer.

We are pleased to report that GLIL recently became a FCA regulated entity following the appointment of the Local Pensions Partnership as the vehicles' regulated operator. This means that other LGPS pools (and other institutional investors) can now invest without the need to be involved in day to day investment management. Further details of the structure and operation of GLIL and its investments made to date are set out in our progress update. So far, GLIL has invested over £1bn in both greenfield and brownfield direct UK infrastructure assets.

GLIL has developed a template for successful sourcing and delivery through an experienced team of investment, compliance, operational, risk and programme management professionals. It is becoming widely recognised as an established, low-cost investor in the UK and international Infrastructure sectors and is very much on the radar for receipt of investment opportunities.

We firmly believe that through collaboration, the local government pension sector can be a world leader in infrastructure investment. This is why we have been developing the GLIL platform to allow other LGPS pools and funds to join.

Value for money

We are proud to be at the forefront of LGPS investments in this area and believe that such investment can meet the twin aims of providing superior risk-adjusted pension fund returns and having a positive impact on the local and national economy.

As we discussed at our meeting, the key principles of the Northern Pool are to ensure value for money for our members, employers and taxpayers by maintaining simple arrangements, via a relatively low number of managers with low manager and portfolio turnover. In order to meet our fiduciary duty, the Northern Pool structure is designed to ensure there is no increase in costs for any participating fund, even in the short term.

Overall implementation costs so far are approximately £700,000 and are expected to be materially lower than earlier estimates. These costs have already been far exceeded by the costs savings generated via making direct infrastructure investments via the GLIL vehicle. All told, **annual cost savings are now expected to be substantially higher than the £28m estimated** in earlier submissions.

Next steps

As you will be aware, much of the recent correspondence between the Northern Pool and Government has been focused on how investment manager selection is delegated to the Pool and in particular concerns set out in the Minister's letter of the 26 July 2018 about delivering the necessary delegation of manager selection to the pool for all three funds.

We have recently received Leading Counsel's advice on the requirements of the LGPS Investment Regulations in this area, which is attached for reference as an appendix to this letter.

We believe it provides the comfort that the Minister is seeking.

The Guidance laid down four criteria which pooling arrangements should satisfy and we believe that we are fully compliant in meeting those as required by law:

1. **Asset pools should achieve the benefits of scale, being at least £25bn in size** - the Northern Pool comfortably satisfies that criterion at a current size of £47.3bn at 30 September 2018.

2. **Strong governance and decision-making** - the managers of segregated mandates will be selected at pool level, available to all Pool partners, so this criterion will be satisfied by these appointments being made by the joint committee, which is being established to oversee the Northern Pool. We are conscious of the Government's strong desire for elected members not to be involved in the selection of third-party managers or individual investments and therefore would like to reassure Government that the Northern Pool inter-authority agreement, which formally establishes the joint-committee, clearly delegates selection decisions to appropriately qualified and experienced officers with such independent and professional advice being taken where expedient. Squire Patton Boggs Solicitors are currently reviewing the Northern Pool inter-authority agreement and delegations to ensure that we address this.
3. **Reduced costs and excellent value for money** - The funds making up the Northern Pool perform extremely well in keeping costs down, in comparison with their peers both global comparators, and within the LGPS. Northern Pool has an estimated average pool cost of 0.45% over year to 31/3/18, this is below the estimated global peer group median actual cost of 0.54% and the estimated global peer group benchmark cost of 0.58% (after controlling for differences in asset allocation). Approximately 80% of costs are in respect of private market assets. The 5 year net value-add for Pool is 0.7% p.a. This is roughly equivalent to £1.5bn of added value as against the local government scheme median of zero and the global median of 0.2%.

The Northern Pool oversight joint committee will use the CEM report in consideration of whether net returns can be improved by reducing, amalgamating or retendering existing mandates across the Pool, including internal mandates, although clearly this will need to be undertaken in line with each fund's investment strategy taking into account liabilities and risk appetite.

4. **Improved capacity to invest in infrastructure** - again, the Northern Pool is a "market leader" in this regard.

We believe Northern Pool continues to lead on meeting the Government's objectives in its reform of LGPS investments, and the independent evidence from the Centre for Evaluation and Monitoring (CEM) would support that assertion.

We very much look forward to further discussion with Government and our stakeholders.

Yours sincerely,

Ian Greenwood
Chair of Northern Pool

Enclosed herewith:

- (a) **Jason Coppel QC legal advice to the Pool & Administering Authorities**
- (b) **Autumn 2018 Progress Report**
- (c) Appendix 1 – CEM benchmarking reports for the year to 31 March 2018 for the three Northern Pools
- (d) Appendix 2 – analysis undertaken by PIRC on the historical risk /return of the funds in the Northern Pool compared to the LGPS funds in London and Wales
- (e) Appendix 3 - current GLIL investments