

**Local Government Pension Scheme:
Investment Reform Criteria and
Guidance**

Report of Don McLure, Corporate Director Resources

Purpose of the report

- 1 To provide Members with information on the Local Government Pension Scheme (LGPS): Investment Reform Criteria recently published by the Government, which provides details of how LGPS funds will be expected to pool their investments.

Background

- 2 In the July 2015 Budget, the Chancellor announced the Government's intention to work with LGPS administering authorities to ensure they pool investments to significantly reduce costs whilst maintaining performance. Considerable emphasis was also given to the expectation that LGPS funds would begin to invest substantially more in infrastructure.

Investment Reform Criteria

- 3 As part of its Autumn Statement, on 25 November 2015 the Government published its Investment Reform Criteria and Guidance, setting out how LGPS investment pooling will work, and reframing the requirement that the pools should take the form of up to six "British Wealth Funds" each with assets of at least £25 billion which are "able to invest in infrastructure and drive local growth".
- 4 It is left to administering authorities to suggest how pooling arrangements should be constituted and will operate, although authorities will need to have regard to the following four criteria:

(i) Asset pool(s) that achieve the benefit of scale of at least £25 billion –

Authorities need to explain the size of the pool when fully operational, any assets proposed to be held outside the pool (with rationale), the type of pool including legal structure, how the pool will operate – what work will be carried out internally and what services hired externally, and a timetable for moving assets into the pool(s);

(ii) Strong governance and decision making

A governance structure should give assurance that at a local level an authority's investment portfolio is being appropriately managed by the

pool in line with investment strategy and in the long-term interest of their members;

At pool level, risk is adequately assessed and managed, investment implementation decisions are made with a long-term view and a continuous improvement culture is adopted;

Authorities need to revisit their internal processes to ensure efficient and effective decision making and risk management while keeping appropriate democratic accountability. Authorities should explain:

- Governance structure of pool(s) including interaction with elected councillors and external scrutiny;
- How authorities can hold the pool(s) to account;
- Decision making processes (and their rationale) at all stages of investment;
- Shared objective for the pool(s), and any policies agreed between participants;
- Resources allocated to running the pool(s), number of staff, skills and expertise required;
- How environmental, social and corporate governance policies will be handled by the pool(s);
- How authorities will act as responsible, long term investors through the pool(s);
- How the net performance of each asset class in the pool(s) will be publically reported and how benchmarking will be used to assess pool(s) and authority performance.

(iii) Reduced costs and excellent value for money

Authorities are encouraged to report more transparently on investment fees and transaction charges, as it is recognised that some transaction charges are sometimes hidden and often not fully reported in pension fund accounts.

Active management should only be used “where it can be shown to deliver value for money”, and authorities should report how active management, net of fees, compares with a passive index. Authorities are also encouraged to set targets for active managers over “an appropriate long term time period”.

The proposals should include:

- A fully transparent assessment of investment costs and fees as at 31 March 2013 and as at a current date;
- A detailed estimate of savings over the next 15 years and of implementation and transition costs and how they will be met.

(iv) An improved capacity to invest in infrastructure

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 infrastructure. Authorities should explain:

- The proportion of their funds currently invested in infrastructure;
- How they might develop or acquire capacity and capability to assess infrastructure projects, and reduce costs through managing investments direct though the pool(s);

- The proportion of their fund they intend to invest in infrastructure and how they arrived at that amount.

Addressing the criteria – requirements and timetable

- 5 Administering authorities need to submit initial proposals to the Government by 19 February 2016. The submission should include a commitment to pooling and a description of progress towards formalising their arrangements with other authorities. The submission can be individual, or joint, or both at this stage.
- 6 Completed submissions are required by 15 July 2016 that fully meet the criteria set out above and in the consultation document. At this second stage submissions should comprise:
 - A joint proposal for each pool setting out the detail of the pooling arrangement e.g. the governance structures, decision-making processes and implementation timetable and;
 - For each authority, an individual return setting out the authority's commitment to and expectations of the pool(s), including their profile of costs / savings, the transition profile for their assets and the rationale for any assets they propose holding outside the pool(s) in the long term.
- 7 The Government will continue to engage with authorities as proposals are developed and will evaluate the initial submissions against the criteria and provide feedback.
- 8 Final submissions will be assessed and a brief report provided in response. The Government will work with authorities who do not develop "sufficiently ambitious" proposals to help them deliver a more cost effective outcome. If this is not possible, other options will be considered including the use of 'back stop' legislative powers included in the proposed new LGPS investment regulations.
- 9 Transition to new pools is expected to start within a further 18 months, with liquid assets being transferred from April 2018. It is acknowledged that illiquid assets could take considerably longer to transfer. While pools are being established, authorities should continue to manage their own investment strategies and manager appointments and keep both under regular review.
- 10 To assist development of proposals, the Government has made available Price Waterhouse Cooper's detailed technical analysis of the different collective investment vehicles and tax arrangements. This suggests an 'Authorised Contractual Scheme' is the most appropriate structure for the LGPS to establish suitable and effective collective investment vehicles to facilitate pooled investment.

Initial pooling discussions

- 11 Officers from the Council attended a meeting in Leeds and a follow-up conference call in November to discuss early options around a potential investment pool focussing mainly on LGPS Funds in the north of England.

- 12 The membership of the group is fluid and as yet no commitments have been made. The LGPS Funds involved in the discussion on 25 November 2015 were as set out in the table below:

Fund	Assets at 31.03.15	Fund	Assets at 31.03.15
Greater Manchester	£17.6 bn	London PFA	£4.6 bn
West Yorkshire	£11.3 bn	Teesside	£3.4 bn
Merseyside	£6.9 bn	North Yorkshire	£2.4 bn
South Yorkshire	£6.5 bn	Durham	£2.3 bn
Tyne and Wear	£6.4 bn	Northumberland	£1.1 bn
Lancashire	£5.8 bn	Total	£68.3 bn

- 13 One significant feature of the group as constituted at that meeting is that over £20 billion of the group's assets are currently internally managed, including almost all the assets of the West Yorkshire, South Yorkshire and Teesside Pension Funds. If the Durham County Council Pension Fund was able to access internal management through a pooled arrangement, this would be expected to lead to reduced overall investment management costs.

Recommendation

Members are asked to:

- 14 Agree that the Corporate Director Resources in consultation with the Chairman and Vice Chairman and after taking appropriate advice, provides an initial response to Government on which pool the Durham Pension Fund may be prepared to join.
- 15 Agree that a progress report will be provided to the next Committee meeting.

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