Agenda Item No: 8

CAMBRIDGESHIRE PENSION FUND

PENSION COMMITTEE

Date: 22 October 2015

Report by: THE DEPUTY HEAD OF PENSIONS

Subject:	**July Budget – asset pooling and the LGPS**
Purpose of the Report	To brief the Committee on the issues arising from the Chancellor's announcement in the July 2015 Budget.
Recommendations	**That the Pension Committee:** 1. Note the briefing on implications of the July 2015 Budget. 2. Note that Officers are:- 2.1 Consulting with DCLG and LGA on asset pooling criteria to be published in November 2015; 2.2 Working with other Funds in a Hymans led project to provide credible proposals for Government approval; 2.3 Collaborating with other funds to discuss specific collaboration to address the Government proposals.
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1. Background

1.1 The Call for Evidence on the future structure of the LGPS was published jointly by DCLG and the LGA in June 2013 and a public consultation exercise ran until 27 September 2013.

1.2 In May 2014, the DCLG released a consultation in response to the call for evidence entitled: *Consultation on opportunities for collaboration, cost savings and efficiencies in the Local Government Pension Scheme*.

1.3 The consultation focussed on how LGPS funds could deliver savings of up to £660m per year by adopting a more collaborative and efficient approach to investment, based largely upon analysis provided in a report commissioned from Hymans Robertson, which suggested that the greatest potential for cost savings would result from greater use of passive management and less use of expensive fund of fund arrangements for alternatives.

1.4 The savings of £660m suggested in the report produced by Hymans comprised investment manager fees (£230m), exiting from fund of funds arrangements for alternatives (£240m) and reduced transaction costs in (£190m). The savings for investment manager fees and transaction costs assumed that all equities and bonds were moved to passive management.

1.5 The Budget in July 2015 included an announcement that the Government would work with LGPS Administering Authorities "*to ensure that they pool investments to significantly reduce costs, while maintaining investment performance*". The Government expects funds to come forward with their own proposals to meet common criteria for delivering savings. A consultation will be published later in 2015 setting out common criteria for cost savings "*as well as back stop legislation to ensure that authorities that do not put forward sufficiently ambitious proposals are required to pool investments*."

1.6 It appears that Government thinking has moved on and that asset pooling is being seen as an alternative means to reducing fees by taking advantage of economies of scale (although it remains to be seen whether backup legislation may suggest a passive approach).

1.7 Transaction costs could be reduced by moving to passive investment but this would need to be consistent with the Government's stated aim of maintaining overall investment performance. It is also worth noting that transaction costs are not a visible cost paid by the LGPS (or any other investor) as they are accounted for within reported performance numbers.

2. Issues

2.1 Until the Government consultation is published, which is expected to be during the Autumn, the criteria against which cost savings will be measured remains open to speculation. However, it is likely that the consultation will ask LGPS funds for specific and quantifiable proposals to deliver asset pooling and subsequent cost savings under the threat of back stop legislation. Whilst the Government has not put a value on the size of the required savings, it is likely to be measured in hundreds of millions in order to be considered "sufficiently ambitious".

2.2 The following issues will need to be considered in preparing for funds' responses to the consultation.

2.3 Asset "pooling" is intended to have a wider meaning than setting up collective investment vehicles ("CIVs"). This could include other initiatives including joint procurement.

2.4 There is the opportunity to build upon work already done by local authorities such as the London CIV, joint procurement initiatives and other collaboration efforts such as Lancashire and the LPFA.

2.5 There may be an emphasis on the size of pools. Some commentators suspect that the Government has in mind pool sizes of tens of billions. Presumably this assumes that pools of this size, with appropriate governance, can deliver significant benefits.

2.6 Potentially larger pools for investment in infrastructure (or other alternatives) may allow funds access to larger and more innovative projects across the UK.

2.7 It is unlikely that the Government will want to operate a default pooled investment vehicle so it is likely that it will look to force funds that fail to propose plans that are sufficiently ambitious to participate in pooling arrangements established by other funds.

2.8 Investment strategy and asset allocation decisions will likely remain with individual pension committees but the selection and dismissal of managers will move to pooled arrangements.

2.9 The potential options range, in order of severity, from: sharing information, joint procurement, pooling assets, Collective Investment Vehicles ("CIVs"), Delegation, Internal teams, to Scheme Mergers.

3. Likely solutions

3.1 It is considered that the likely solutions will be found in the middle of this range i.e. joint procurement, pooling assets and CIVs.

3.2 Before considering new opportunities for collaboration with other funds, it is a natural point to start by assuming that the Cambridgeshire and Northamptonshire funds will build upon the recent joint procurement exercises for Global equity managers with a renewed focus on achieving joint outcomes that will maximise fee savings.

3.3 In the market, passive management fee scales are increasingly competitive, driven by a small number of providers and the fact that there are clear economies of scale with passive management. Joint procurements may drive down fees by several basis points, but in the context of the average LGPS fund of £2.5bn a saving of 1 bps equates to £250,000, the potential savings are not considered sufficiently ambitious.

3.4 Pooling funds would mean agreements between funds to appoint the same managers and to unitise each fund's holding. However, although there is some commonality between mandates across LGPS it is unlikely to be enough to simply pool assets in their current form.

3.5 CIVs are a more formal version of asset pooling and may represent a longer term solution. They are housed within a (FCA) regulated structure that may be either built by the funds or "rented" from a third party provider.

3.6 There are a range of CIV models each of which would have an investment committee (whose membership may include representatives of the investing authorities) that determines manager selection decisions. Depending upon the model chosen the economies of scale come from the collective assets of the funds involved but may well also leverage the scale of assets of the third party provider of the "rented" structure.

3.7 In a pooled arrangement the governance arrangements over manager selection and monitoring will fall to the CIV investment committee rather than committees of the investing LGPS funds who invest collectively. It will be important to ensure that the CIV's governance arrangements are robust in order to ensure that investment performance is maintained in line with the Government's brief. Strategic asset allocation and funding issues which have the greatest impact at fund level will remain a responsibility at a local fund level.

4. Officer Engagement.

4.1 Both Funds are represented on the LGPS Pooling working group supported by Hymans, the objective is to provide a cohesive set of acceptable proposals, avoiding a myriad of overlapping proposals the majority of which are unlikely to meet government criteria.

4.2 In addition officers have instigated meetings with other Funds to create a collective of like minded Funds to facilitate discussions on how Funds will collaborate on the acceptable proposals going forward.

5. Summary of conclusions and next steps

5.1 The Government consultation due later in 2015 is expected to seek ambitious proposals from LGPS funds that set out specific and quantifiable plans that are designed to deliver a significant level of cost savings that can only be delivered through the scale that results from increased collaboration between funds.

5.2 Funds that do not provide sufficiently ambitious plans may be covered by backstop legislation and be forced to join a pooling arrangement.

5.3 Officers of the Fund have attended feedback meetings with DCLG and LGA to influence the autumn criteria guidance and the new investment regulations. Additionally officers have engaged proactively with other Funds to better inform both the pre autumn consultations and the February 2016 responses.

5.4 Both Funds are represented on the LGPS Pooling working group supported by Hymans, to produce credible and widely supported proposals, which individual Funds will adopt in their specific collaborative discussions to form asset pools.

6. Recommendation

6.1 The Pension Committee is asked to:

6.1.1 Note the briefing on implications of the July 2015 Budget.

6.1.2 Note that Officers are:-

1) Consulting with DCLG and LGA on asset pooling criteria to be published in November 2015;

2) Working with other Funds in a Hymans led project to provide credible proposals for Government approval;

3) Collaborating with other funds to discuss specific collaboration to address the Government proposals.

7. Relevant Pension Fund Objectives

Perspective	Outcome
Funding and Investment	• To ensure that the Fund is able to meet its liabilities for pensions and other benefits with the minimum, stable level of employer contributions. • To ensure that sufficient resources are available to meet all liabilities as they fall due. • To maximise the returns from its investments within reasonable risk parameters.

8. Finance & Resources Implications

8.1 There are no financial or resource implications at this time that require consideration.

9. Risk Implications

a) Risk(s) associated with the proposal:

Risk	Mitigation	Residual Risk
None at this stage – no action being suggested other than to investigate potential options	n/a	n/a

b) Risk(s) associated with not undertaking the proposal:

Risk	Risk Rating
The Government may impose investment structures using backstop legislation without proper input by LGPS funds.	Amber

10. Communication Implications

10.1 Not applicable.

11. Legal Implications

11.1 Not applicable.

12. Consultation with Key Advisers

12.1 The report was produced in consultation with Mercer Limited, the Fund’s appointed Investment Consultant, and in compliance with the LGPS (Management and Investment of Funds) Regulations 2009.

13. Alternative Options Considered

13.1 None.

14. Background Papers

14.1 None.

15. Appendices

15.1 **Appendix 1** – Extract from Summer Budget July 2015.

Checklist of Key Approvals	
Is this decision included in the Business Plan?	No.
Will further decisions be required? If so, please outline the timetable here	No
Is this report proposing an amendment to the budget and/or policy framework?	No.
Has this report been cleared by the Deputy Head of Pensions?	Mark Whitby – 25/09/2015
Has this report been cleared by the Section 151 Officer / Director of Finance?	Sarah Heywood – 29/09/2015
Has the Chairman of the Pension Fund Board been consulted?	Councillor Hickford – 29/09/2015
Has this report been cleared by Legal Services?	Copy sent to Quentin Baker – 09/10/2015

Extract from Summer Budget 2015

Copy of the Summer Budget Report – July 2015 as laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget.

Page 78

2.19 Local Government Pension Scheme pooled investments – The government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance.

The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments.