

# Pensions Committee

7 December 2016

<b>Report title</b>	Investment Pooling	
<b>Originating service</b>	Pension services	
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## Recommendation(s) for action or decision:

The Committee is recommended:

- 1.1. To enter into a joint agreement with Cheshire West and Chester Council, Derbyshire County Council, Leicestershire County Council, Nottinghamshire County Council, Shropshire Council, Staffordshire County Council, and Worcestershire County Council to establish a joint pension fund investment pool, in accordance with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016; to be overseen by a Joint Committee established under s102 of the Local Government Act 1972.
- 1.2. To become a joint shareholder of LGPS Central; a private company, limited by shares, held solely by the participating funds, on a 'one fund, one vote' basis; incorporated for investment management purposes and regulated under the Financial Services and Markets Act 2000.
- 1.3. To appoint the Strategic Director of Pensions to represent the Council on a Practitioner Advisory Forum, providing joint officer support to the Joint Committee and Shareholders' Forum.
- 1.4. To authorise the Strategic Director of Pensions and the Council Solicitor to enter into all necessary legal agreements to establish a joint asset pool and investment management company.
- 1.5. To approved revised terms of reference for Pensions Committee as set out in Appendix 1 to this report to take effect from 1 April 2018.
- 1.6. To approve the consolidation of Pensions Committee and Investment Advisory Sub Committee from June 2017 in light of the pooling arrangements.

## 1.0 Purpose

- 1.1. This report outlines the changes that will be required to the operational and governance arrangements for West Midlands Pension Fund following the recent amendment of the LGPS Investment Regulations.
- 1.2. The revised regulations require all administering authorities in England and Wales to enter into joint (pooled) arrangements for the management of their investment assets, with effect from 1<sup>st</sup> April 2018, in order to achieve scale economies and increase investment capacity.
- 1.3. West Midlands Pension Fund has been working with seven partner funds on a proposal which will meet the criteria for pooling laid down by the Secretary of State, by establishing a jointly owned investment management company, to be known as 'LGPS Central Ltd'.

## 2.0 Background

- 2.1 The LGPS is one of the largest funded pension schemes in the world with combined assets of around £200 billion. These are managed by 89 local administering authorities, who have historically maintained separate arrangements for the management of scheme assets, overseen by their respective Pension Fund Committees.
- 2.2 Between them it is estimated that administering authorities incur total administrative and management costs of around £500 million per year, a significant proportion of which relates to investment management fees paid to external fund managers. It should be noted that this figure is based on reported costs, the precise treatment of which varies between funds, therefore this figure is underestimated. Funds often use the same managers, offering the same or similar services but appointed under separate agreements and on different fee terms.
- 2.3 Funds also vary significantly in scale; large funds enjoy direct access to a wide range of investment markets and products and can often negotiate more competitive fees, whilst smaller funds have more restricted options due to lower levels of investible resources and expertise, and have less negotiating power in the market.
- 2.4 Over the past two and a half years the Government has explored a number of options for improving the efficiency and sustainability of the scheme, and has undertaken extensive consultation on the potential to deliver savings through greater collaboration. A national cost benefit exercise, led by Hymans Robertson concluded that significant savings could be achieved through greater use of collective investment approaches, provided that certain regulatory restrictions were removed.
- 2.5 Subsequently, the Government announced its intention to introduce a new regulatory framework which would facilitate collective investing and issued guidance and criteria to help administering authorities to develop proposals for pooling, aimed at reducing costs and improving efficiency. Initial proposals were required by February 2016, followed by more detailed business case submissions in July 2016, with a target implementation date of 1<sup>st</sup> April 2018. The Government also announced that 'backstop' powers would be introduced to allow the Secretary of State to intervene where authorities failed to bring forward sufficiently ambitious proposals in accordance with the guidance and criteria issued.

2.6 Over the last 12 months, the Pensions Committee and Local Pensions Board have been kept informed of the work of the Fund in meeting Government's criteria. Legal workshops have been organised with representatives from all the Administering Authorities, together with presentations and reports presented to each committee meeting outlining the proposed governance structure and associated implications as submitted to Government in July 2016. A further Stakeholders' day is organised on 24 January 2017 for both the Pensions Committee and the Local Pensions Board.

### **3.0 LGPS Central**

3.1 Prior to the Government's announcement, West Midlands Pension Fund has already established close working links with a number of other funds across the UK. These informal links become the starting point for wider discussions in the context of the formal requirement for pooling, resulting in a joint proposal from Cheshire, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands (including the ITA Fund) and Worcestershire pension funds to create 'LGPS Central', with combined assets of £35 billion.

3.2 Following confirmation from the Minister that this proposal was acceptable, a joint working group of officers, supported by external advisors, developed a detailed business case setting out how LGPS Central will meet the four key assessment criteria laid down by the Government :-

Criteria 1 – Asset pool(s) that achieve the benefits of scale (greater than £25 billion)

Criteria 2 – Strong governance and decision making

Criteria 3 – Reduced costs and value for money

Criteria 4 - Improved capacity and capability to invest in infrastructure

3.3 In readiness for meeting Government's timetable of April 2018, LGPS Central Ltd has been incorporated as a company registered with Companies House. To assist in its creation, and in agreement with all the Administering Authorities, Wolverhampton City Council established the company as the subscriber shareholder with a sole Director. This is a process matter to ensure the creation of the company. The other 7 Authorities will subscribe to the company following finalisation of adoption of agreements.

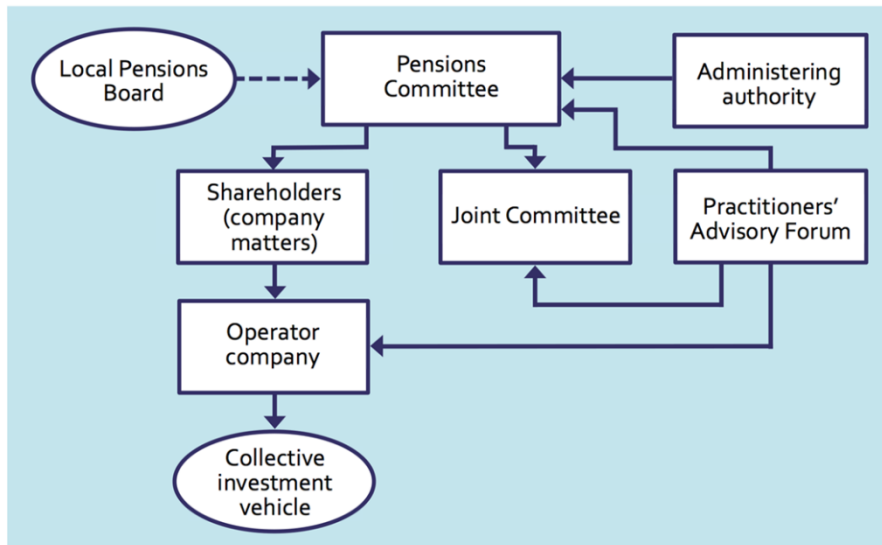
### **4.0 Governance Structure**

4.1 Detailed reports have been presented to previous meetings of the Pensions Committee, explaining the key elements of the business case and seeking approval for the proposed governance, oversight and management structure of the pool.

4.2 The structure will allow participating funds to exercise control (both individually, and collectively) over the new arrangements, not only as investors in the pooled fund, but also as shareholders of the operator company. West Midlands ITA Pension Fund will not be a shareholder of the company in its own right, but will be represented through West Midlands Pension Fund, in line with the delegations previously granted to this Committee.

4.3 The Outline below shows the Governance structure

**Summary of Governance Structure**



- 4.4 At its last meeting in September, Pensions Committee approved the nomination of its Chair (with Vice Chair as substitute) to represent the Fund on both the Shareholder Forum and the Joint Committee.
- 4.5 The Government has also made clear its expectation that pooled entities must be registered with the Financial Conduct Authority (FCA) and regulated under the Financial Services and Markets Act 2000, to ensure appropriate safeguards over the management of client monies. As such, the new LGPS Central company will be subject to on-going oversight by the regulator and key management positions, including the company directors, will need to be 'approved persons', able to demonstrate appropriate knowledge, expertise and track record in investment management. They will also carry significant legal, personal liability for their actions and decisions.
- 4.6 The relative merits of buying or renting an established operator to manage the day-to-day running of the pool have been carefully considered against the benefits of setting up a jointly-owned company, with associated shareholder rights. The constituent funds unanimously agreed that the latter option, whilst more expensive, offers significant advantages in terms of greater flexibility and control, and this is the basis upon which the business case has been developed.
- 4.7 Whilst assets will be managed on a pooled basis, each fund will be able to exercise their investor rights independently, although clearly, benefits of scale will most effectively be harnessed where parties work together in a co-ordinated way to align their decision-making. An important example being Responsible Investment Policy, e.g. environmental, social, and governance policies and policies on the exercise of voting rights.

- 4.8 The Shareholders' Forum, operating under company law, will have formal decision-making powers. West Midlands Pension Fund will have equal voting rights alongside the other participating funds, and unanimous decisions will be required on key strategic matters, which will be specified in the company Shareholders' Agreement and Articles of Association. This will include the appointment and dismissal of the company's senior executives, approval of the company's strategic plan and any significant financial transactions, such as major acquisitions and lending or borrowing.
- 4.9 The degree of control to be exercised by the Shareholders through their reserve powers will be greater than is generally the case, ensuring the company is a publicly owned company over which the public authorities have direct control. This is to satisfy the exemption criteria in regulation 12 of the Public Contracts Regulations 2015 (Teckal) therefore avoiding the need for a full procurement exercise to procure the services of the company.
- 4.10 To comply with this regulation, there will be certain reserved matters which will require unanimous approval before the actions can be implemented. These include, in the main, appointing and removing Directors, the admission of new joiners, approving strategic plans, approving accounts and audits and decisions on borrowing/lending powers. Other matters not directly related to the control of the company but to manage its operation are subject to a majority approval (75%) and these include payments of dividends and entering into lease agreements/capital expenditure.
- 4.11 The Joint Committee, created under S102, Local Government Act 1972, will be the forum for dealing with common investor issues, and for collective monitoring of the performance of the pool against the objectives set out in the LGPS Central business case submission. It will however, have no formal decision making powers and Joint Committee recommendations will require the approval of individual authorities, in accordance with their local constitutional arrangements.
- 4.12 To support the Joint Committee in its role, a Practitioner's Advisory Forum (PAF) will be created consisting of officers from each of the individual Funds. The PAF will support Joint Committee meetings and action any recommendations, including the reporting back to Fund Pension Committees of matters requiring their attention.

## **5.0 TUPE/ Location**

- 5.1 It is expected that employees who are currently employed by the partner funds to manage their investments or perform other related activities will transfer under the Transfer of Undertakings (Protection of Employment) regulations (TUPE) to the new company, subject to detailed consideration of current and future roles.
- 5.2 It has been agreed that LGPS Central Ltd will be based at 2 locations. The headquarters will be based in Wolverhampton with a satellite office in Matlock Derbyshire.

## **6.0 Government's Approval**

- 6.1 The detailed business case has been reviewed by a joint DCLG/HMT Review Panel in early September 2016. The Pool met with the Minister on 15 November to discuss the submission and following the discussion, received a letter of confirmation from the Minister that he is content for LGPS Central to proceed as set out in our final submitted proposal.

## **7.0 Impact on the role of the West Midlands Pension Fund Committee/Investment Advisory Sub-Committee**

- 7.1 The current terms of reference for the West Midlands Pensions Committee and the Investment Advisory Sub-Committee are attached in Appendix 1, along with suggested amendments to reflect their post-pooling responsibilities (highlighted in track changes). These changes will be taken through the Council process for amending the constitution in time for the next municipal year in June 2017.
- 7.2 For the most part, the role of the Pensions Committee will be unaffected by the implementation of pooling and the creation of LGPS Central. The Committee will continue to be responsible for monitoring the overall management, performance and administration of the fund, and for setting investment strategy, including the overall allocation of assets, which is the critical factor in determining investment performance.
- 7.3 Importantly, the Pensions Committee will also continue to be responsible for communicating with individual scheme members, whose benefits are set in law, and which are therefore not affected by the new pooling arrangements or investment performance.
- 7.4 Responsibility for direct investment management through an in-house team and appointing external investment managers and overseeing their performance, including any decision to dismiss, previously delegated to the Strategic Director of Pensions, will transfer to the pool, as will tactical decisions on the implementation of the overall investment strategy and the choice of specific investment vehicles.
- 7.5 The role of the Investment Sub-Committee will be more fundamentally impacted by the pooling proposals, as its remit is focussed specifically on the review of investment manager performance and other service provider issues, which will become the responsibility of the pool operator. With reduced terms of reference the residual role of the Sub-Committee could be subsumed back in to the main Committee, thereby streamlining the overall governance arrangements and reducing the demands on Trustee's time.
- 7.6 From June 2017, it is proposed that there is one meeting of Pensions Committee which will be divided between Exempt, commercially sensitive reports, for example transition of assets to the pool and Non-Exempt reports.

## **8.0 Financial implications**

- 8.1 The estimated cost of setting up the jointly owned company is circa £4 million; this will be shared equally between the participating funds, with West Midlands' share being around £500,000. There will also be significant transition costs as existing investment mandates are unwound and funds are transferred into new collective investment vehicles. It is not possible to accurately predict these costs, but the business case includes an estimate of approximately £50 million. Transition costs will also be shared between the funds on a fair and equitable basis.
- 8.2 In addition, as the new company will be a regulated entity, under FCA rules, it will likely need to hold regulatory capital to guarantee its solvency. The regulatory capital requirement is expected to be in the region of £8 million (£1 million per fund).

- 8.3 West Midlands Pension Fund's share of all costs (including the regulatory capital) will be met from the fund, and there will therefore be no direct impact on the administering authority's revenue or capital budgets. This is currently being reviewed in the context of tax implications by PWC.
- 8.4 Estimated net total savings for the pool as per the July submission to Government, are in the region of cumulative £200 million over the period from 2018/19 to 2032/33, with annual savings of around £29 million being achieved by the end of this period.

## **9.0 Legal implications**

- 9.1 The requirement to pool fund investments is a requirement of law, failure to work collaboratively and meet the Government's criteria and timetable for delivery may result in Government intervention.
- 9.2 The key risks are:-
- failure to achieve the statutory implementation deadline of 1<sup>st</sup> April 2018
  - failure to manage costs and savings in line with the agreed business case
  - failure to meet the requirements of the FCA regulator
  - failure to recruit appropriately skilled and experienced senior personnel to the new company
- 9.3 Comprehensive programme governance arrangements are in place to ensure that the statutory deadline for the implementation of pooling is achieved and that costs and savings are managed in accordance with the agreed business case. The S151 officers of each of the participating funds sit on the LGPS Central Programme Board and regular joint meetings are held between the Chairs and Vice-Chairs of the respective Pension Fund Committees to ensure effective member oversight of progress and delivery. The West Midlands Pension Fund Committee and Local Pensions Board are also being updated regularly on key developments and decisions, as are the fund employers.
- 9.4 Expert advisers have been appointed to provide support to LGPS Central on legal matters, FCA registration, taxation and overall programme management, and professional recruitment consultants are being appointed to assist and advise on executive recruitment and remuneration.
- 9.5 Browne Jacobson were appointed jointly by the Funds to assist them with their governance arrangements in approving the documents which have been agreed by the Council Solicitor.

## **10.0 Equalities implications**

- 10.1 There are no implications

## **11.0 Environmental implications**

- 11.1 There are no implications

## **12.0 Human resources implications**

12.1 Outlined in the report

## **13.0 Corporate landlord implications**

13.1 Considerations for office space which meet the Pool's requirements are ongoing together with the associated resources. An update will be provided as this progresses.

## **14.0 Schedule of background papers**

14.1 Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

<http://www.legislation.gov.uk/uksi/2016/946/contents/made>

14.2 Public Contracts Regulations 2015

<http://www.legislation.gov.uk/uksi/2015/102/contents/made>

## **15.0 Appendices**

15.1 Appendix 1  
Amended Pensions Committee Terms of Reference