Leicestershire County Council

LOCAL PENSION COMMITTEE – 13TH NOVEMBER 2015

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

ASSET POOLING WITHIN THE LOCAL GOVERNMENT PENSION SCHEME (LGPS)

Purpose of the Report

1. To inform the Committee of the current position in respect of the ongoing unofficial consultation that is taking place in respect of the Government's ambition to ensure that the LGPS pools its assets in such a way as to introduce greater economies of scale (and hence reductions in running costs).

Background

2. In May 2013 the then-Local Government Minister Brandon Lewis made clear in a speech that the structure of the LGPS was being considered, with Fund mergers a possibility for consideration. This speech was followed by a 'Call for Evidence' consultation that focused on the management of deficits and investment efficiency.

3. In May 2014, and following analysis of the responses received from the Call for Evidence, a further round of consultation was launched. This consultation ruled out forced Fund mergers in the near term and focused on the possibility of asset pooling (possibly via the formation of a small number of Common Investment Vehicles) and the increased use of passive management, both of which were thought to offer potentially significant savings in investment management fees across the LGPS.

4. The Summer Budget of July 2015 contained the following announcement:

   "The government will work with the 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."

5. Subsequent to the Budget, it has become clear that there will not be a formal consultation on the matter of asset pooling. Instead discussions between individual Funds, representatives of Funds (such as the Local Government Association and investment consultants) the Department for Communities and Local Government (DCLG) and the Treasury are considered to be the consultation. There is an expectation that the DCLG will issue details of the criteria against which options for pooling will be appraised sometime in November.

6. In early October the Chancellor of the Exchequer delivered a speech at the Conservative Party conference that strongly pointed to the creation of six ‘British Wealth Funds’ from the assets of the 89 English and Welsh LGPS Funds. This announcement formed part of a four-point plan to boost infrastructure investment in the UK, and there is a clear view within Government that the LGPS does not invest sufficiently in infrastructure (a lack of expertise has been cited as the reason) and that it can be part of the solution to funding the UK’s requirement for capital.

7. Within a very short time of the Chancellor’s speech, a letter was issued by the DCLG (attached as an appendix) that tried to soothe fears that a decision concerning the LGPS assets had already been made and to make it clear that the views of the LGPS itself would be taken into account before a final structure is agreed.

Current position in respect of ‘pooling’

8. with asset pooling inevitably being introduced within the lifetime of this Parliament, over 20 LGPS Funds (including Leicestershire) have been working to deliver options to the Government about how pooling might work best, and this project has been instigated and supported by Hymans Robertson. It is hoped that putting forward proposals that have been costed, where the pros-and-cons have been considered and are supported by a large number of Funds, will help to influence the final outcome. The emphasis is on ensuring that the fund ends up with something that is workable, gives flexibility to ensure that they can continue to deliver their own asset allocation strategies, has a governance structure which ensures Funds still have an impact on their own performance and maximises costs savings (whilst still ensuring that investment performance is acceptable).

9. Whatever the final structure, it is unlikely that it can be all-things-to-all-people. Economies of scale, for example, will be achieved by having less investment managers with larger mandates and in order to do this it is entirely possible that individual manager appointments will be taken out of the hands of individual Funds. So instead of choosing manager X for a segregated UK active equity mandate, the Fund’s decision might be to invest in the UK active equity ‘sleeve’ of a common investment vehicle and this ‘sleeve’ might include 4 managers who will each manage some of the Fund’s investment (though not necessarily on an equal basis).

10. The default option appears to be regional pooling, whereby the geographic location dictates Funds within a pool. Alternatives are asset class pools on a national basis or some mixture of these – possibly alternatives on a national basis and listed assets within regional pools. In reality there is an almost endless list of options. The DCLG has suggested pools of £20 - £30bn (which they believe to be the optimum size to achieve economies of scale, before diseconomies start to happen), but it might be that they ultimately accept that some pools can be smaller than this and still maximise savings.

11. The DCLG have not ruled out anything and may accept groups of like-minded Funds who put forward an acceptable proposal, and there are already signs of some Funds competing for position in this respect. This is a potentially dangerous position for the LGPS as there is a chance that this will leave a number of Funds ‘detached’ and without any natural partners; having five out of six pools that function

well and one dysfunctional one does not seem a sensible outcome for the Government to preside over.

12. Leicestershire will continue to be involved in work that seeks to achieve the best possible outcome for both the Fund itself and the LGPS as a whole. The situation is fluid and there will no doubt be Government announcements and decisions that continue to influence the direction of travel. At present it is expected that the Chancellor will want to announce something meaningful about the future structure of the LGPS in his March Budget, and the intention is to have completed the joint-working being supported by Hymans (as referred to in paragraph 9) by the end of December. This should allow the DCLG and Treasury time to consider all of the options available before they make a recommendation about their preferred outcome.

13. So far the DCLG and Treasury appear to have been willing to listen to the views of the wider LGPS community (Funds, investment advisors, investment managers etc.), and it is hoped that this will continue. If this is the case we should end up with an outcome that is the best one possible, but it has to be accepted that there is a political dimension to this matter that may ultimately produce a sub-optimal outcome.

Recommendation

14. The Committee is asked to note this report.

Equal Opportunities Implications

None specific

Appendix

DCLG Letter

Officers to Contact

Colin Pratt – telephone (0116) 305 7656
Chris Tambini – telephone (0116) 305 6199