Impact of investment pooling onto role of Local Pension Committee

Colin Pratt

Asset Allocation

- Funds will retain responsibility for setting their own asset allocation (i.e. in which markets they wish to invest)
- LGPS Central will be responsible for implementing these asset allocation decisions
- Pooling the investment wishes of nine Funds will lead to bigger portfolios, and significant economies of scale

Asset Allocation

- Funds will continue to decide whether they wish to invest actively or passively
- LGPS Central will be responsible for the appointment and on-going relationships with investment managers
- Some investment management will be carried out by LGPS Central, but the majority will initially be external
- Hoped to ‘internalise’ more assets over time

Manager Selection

- Local Pension Committee will lose any influence on manager appointments (currently mainly carried out by the Investment Subcommittee)
- Manager appointments only the ‘icing on the cake’
- Asset allocation accounts for about 90% of investment performance
- No reason to suggest that LGPS Central will make worse appointments than we would

Other Policy Issues

- Everything else remains as it currently is
- Key actuarial valuation assumptions will continue to be agreed by this committee
- Policy documents such as Investment Strategy Statement and Funding Strategy Statement remain the responsibility of this committee

Practical implementation of asset pooling

- How to get from a Fund's current position to the final structure?
- Important to note that re-structuring will be over a number of years
- Fund's will have flexibility to change their requirements
- But Pool will not offer investment management options that are 'sub-scale'

Practical implementation of asset pooling

A

Worked

Example

Current asset structure

Asset Class	Benchmark Weighting	Number of Managers
UK Equities	7.5%	1 – Passive Life Funds
Regional Equities	26.5%	1 – Passive Life Funds
Global Equities	8.0%	2 - Active
Emerging Market Equities	4.0%	1 - Active
Private Equity	4.0%	2 - Active
Property	10.0%	2 – one direct, one pooled
Index-Linked	7.5%	1 - Active
Infrastructure	5.0%	3 - Active
Global Credit	7.5%	3 - Active
Emerging Market Debt	2.5%	1 - Active
Timberland	2.0%	1 - Active
Targeted Return	13.0%	3 - Active
Other Opportunities	2.5%	3 - Active

Transfer of Assets to LGPS Central

- All assets will be transferred to LGPS Central on 1st April 2018
- LGPS Central will be responsible for 'oversight' of the assets from this date
- Significant action in respect of existing managers is unlikely until the asset class is restructured
- Restructuring will be phased – those assets with biggest savings will be first

Passive Assets – Life Funds

- All passive assets are currently in pooled Life Funds
- These assets will be transferred to LGPS Central for oversight, but no other change is necessary
- LGPS Central will be responsible for monitoring the manager and ensuring required asset allocation is maintained
- Other than that, no change

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Property	10.0%	2 – one direct, one pooled
Private Equity	4.0%	1 – fund-of-funds
Index-Linked	7.5%	1 - Active
Infrastructure	5.0%	3 - Active
Global Credit	7.5%	3 - Active
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Liquid Assets

- Mainly equities and bonds
- Sub-funds will be set up within each asset class, with each Partner Fund having a choice about whether to invest in the sub-fund
- Sub-funds will be unitised, and units will be able to be bought and sold on a regular basis
- Sub-funds will achieve economies of scale by combining the assets of all Partner Funds
- All Partner Funds need to agree the performance objective of the sub-fund

Liquid Assets

- Sub-funds likely to be sizeable, and the assets within them are likely to be managed by multiple investment managers
- Multiple investment managers allows exposure to different investment styles and reduces individual manager risk
- Need to avoid over-diversification
- Significant economies of scale achieved by appointing managers to sizeable portfolio sizes

Liquid Assets

- Sub-funds for liquid assets are likely to be structured as Authorised Contractual Schemes (ACS)
- ACS sub-funds in UK equities, regional equities, global equities, emerging market equities, passive equities and various bond asset classes

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‘Closed-Ended’ Funds

- Some investments are structured as closed-ended funds (Private equity, infrastructure, specialist property etc.)
- These will generally invest money and look to realise the investments made within a specified period of time
- No ‘natural’ ability to add or reduce to investment until the fund is ‘wound-down’

‘Closed-Ended’ Funds

- Will be transferred to LGPS Central, but will be allowed to ‘run off’ naturally, except in extreme circumstances
- The transferring Fund will retain full exposure to the closed-ended fund
- With probable exception of closed-ended property funds with a meaningful remaining period until wind-down. These may form part of the ‘pooled property’ sub-fund

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Property

- Property likely to have at least two sub-funds – one for direct property and one for pooled property
- Expected to move towards more direct property investment over time, as costs will be much cheaper
- Pooled property will still have a place in certain niche areas

Property

- Various issues around both direct and indirect property (including tax implications of asset transfers) means that future structure is currently undecided
- But intention is to transfer all existing property assets into a pooled arrangement, unless there is a sound reason for excluding them

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Targeted Return

- A number of Funds have portfolios that could be generally classified as ‘targeted return’. Other names are diversified growth funds and absolute return
- There are a huge variety of ways to achieve a ‘targeted return’, and the required outcome is key
- Some form of targeted/absolute return sub-fund is likely to exist, but work needs to be done on agreeing the principles and return objective

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Other Opportunities

- Some Partner Funds have scope to invest in attractive opportunities that do not fit in neatly with their strategic asset allocation
- These opportunities are often caused by market dislocation and will not always be open to investment for long periods of time
- Often higher risk/higher return opportunities, so not considered appropriate by all Partner Funds

Other Opportunities

- On-going discussions about how to access these opportunities within a pooled investment environment, but high probability that a suitable arrangement can be agreed
- Exact structure and method of access will be agreed in due course.

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Future Investment in Illiquid Assets

- For the purposes of this presentation, illiquid assets are defined as those that are not equities, bonds or property
- Current LCC illiquid asset classes are private equity, infrastructure, timberland and 'other opportunities'
- These investments are generally accessed via closed-ended funds

Future Investment in Illiquid Assets

- Leicestershire the only LGPS Central currently invested in timberland, at a total value of £80m. LGPS Central is unlikely to offer a timberland sub-fund due to lack of scale, so the existing closed-ended fund investments will ‘wind-down’ naturally and distribution proceeds will not be invested back into the asset class
- ‘Other opportunities’ will be dealt with, but no decisions yet taken

Future Investment in Illiquid Assets – Private Equity

- Partner Funds have meaningful exposure to private equity through a mixture of investment into closed-ended funds (as a ‘limited partner’), and the employment of fund-of-funds managers
- Fund-of-funds incurs a further level of fees over-and-above investment as a limited partner
- Direct or co-investment is a cheaper option, but increases the risks inherent within individual decisions

Future Investment in Illiquid Assets – Private Equity

- Partner Funds need to deploy significant capital into private equity on an annual basis, simply to maintain a weighting that is close to their target. Significant distributions are being received from the sale of investments
- Some Partner Funds also looking to increase their weighting within the asset class
- Some Partner Funds already have internal private equity investment experience

Future Investment in Illiquid Assets – Private Equity

- Solution is likely to be a mixture of using internal management to access certain limited partner investments, and an external manager to access other limited partner investment where internal resource is currently insufficient
- Greater use of co-investment opportunities and possibly even direct opportunities
- Expectation that internal resource will be built gradually, but an acceptance that LGPS Central may not be able to do everything itself

Future Investment in Illiquid Assets – Infrastructure

- Infrastructure likely to be a growing area
- Most existing infrastructure accessed via the closed-ended funds of external managers
- Opportunity to build resource internally
- Internal resource will lead to lower cost, via increased use of co-investment and direct investment
- External managers still likely to be used as well

Building Internal Pool Resource

- LGPS Central needs to walk before it can run – initially stick to what it already does, and will grow gradually and sustainably
- Some external appointments likely in the near term, but ‘growing our own’ a long-term LGPS Central aim
- Unlikely that LGPS Central will ever offer a solution that is entirely internally-managed

Why internal resource?

- It gives better control over both risk and cost
- Can be considerably cheaper, but cost is not everything
- Lower cost gives an inherent advantage, but net returns are ultimately the most important issue
- Internal resource growth likely to be gradual and only in areas where it is felt value can be added