

BACKGROUND

Collaboration across the eight LGPS pension funds in Wales is not new. In recent years, there has been support from elected members across all eight funds to explore the opportunities for achieving efficiencies within the areas of funding and investment by considering issues such as scheme mergers and collaboration on investments.

In March 2013, the Pensions Sub Group of the SWT published a substantial report ('Welsh Local Government Pension Funds: Working Together') which included a formal consultation process.

Following guidance from the wider DCLG Consultation on Cost savings and Efficiency, the Pensions Sub Group commissioned a further report in early 2015 on the development of a detailed business plan for the establishment of a common investment fund.

UK GOVERNMENT - AGENDA FOR STRUCTURAL REFORM

In July 2015, the UK Government suggested that all LGPS assets within England and Wales should be pooled. Informal discussions with funds commenced in the summer and it was made clear that the funds themselves would be invited to put forward their own proposals as to how asset pooling might best be implemented. Discussions began across the Scheme on the possible composition of the different asset pools.

In September 2015, each of the eight Welsh funds' Pensions Committees formally resolved to set their own course significantly in advance of the guidelines which were subsequently laid down by DCLG / HMT. Decisions were taken to:-

- appoint a single provider of passive management services for funds, and
- proceed with establishing a formal Collective Investment Vehicle (CIV) to facilitate asset pooling.

It was also decided that the funds would use a third party provider (an 'operator') to supply the necessary infrastructure for establishing a pooling vehicle fully regulated by the FCA (Financial Conduct Authority) - rather than creating their own vehicle.

This decision was made taking into account the limited internal resources available to establish its own pooling vehicle, the shorter timescales for likely implementation and the lower level of regulatory risk that such an approach would imply.

In November, the formal criteria were issued by DCLG against which the pooling proposals put forward by the LGPS would be assessed. There were four key criteria:-

- Scale
- Strong governance and decision making
- Cost efficiency and value for money
- Improved capacity to invest in infrastructure

The Welsh funds reviewed their progress to date on pooling investments and decided to proceed with establishing a Wales Pool within the guidelines laid down by UK Government, through the DCLG.

FEBRUARY SUBMISSION

A proposal for a Wales Pool was submitted to DCLG in line with their prescribed timetable by 19 February 2016, along with letters of support from each of the relevant Committee Chairs.

The proposal addressed each of the stated criteria except for scale where DCLG had indicated that they anticipated pools with a minimum of £25bn of assets. (Total assets across the Welsh funds were in the region of £12-13bn. at March 2015). The proposal also stressed the substantial work done to date and unique situation of collaboration across Wales.

The response to the proposal from DCLG strongly supported the intended use of a formal regulated vehicle and acknowledged the unique characteristics of a Wales Pool. The funds were encouraged to work up the proposal in more detail for submission in July.

JULY SUBMISSION

More detailed submissions have been requested from all the proposed pools by 15 July.

These submissions will need to provide more detail on:-

- The proposed governance arrangements, including the legal structure of the proposed pooling arrangements and how accountability to participating funds will be maintained.
- The nature of the asset pools which will be made available to funds and how investment in different asset classes will be implemented.
- Estimated cost savings for each individual fund and the timescale over which these might be achieved.
- The pool's approach to investment in infrastructure.

Therefore, a number of decisions need to be taken in relation to the proposed working of the pool over the next few weeks.

WHAT WILL IT MEAN FOR ADMINISTERING AUTHORITIES?

One of the key principles is that administering authorities will retain control over setting the investment strategy and detailed asset allocation for their individual funds. This allows the broad risk and return characteristics of the strategy to be set in conjunction with each fund's overall funding strategy.

But funds will then invest in asset pools which will be made available by the operator of the Wales Pool.

One of the Government's aims is that the appointment of investment managers is no longer carried out at an individual fund level. Decisions on investment managers for each asset class or mandate will be made collectively at a pool level.

Governance arrangements will be put in place to allow oversight of the operator and ensure accountability back to individual funds.

One of the principles behind the Government's imposition of pooling is that larger asset pools will result in fee savings with investment managers. Within Wales, this has already been achieved through the passive manager appointment which has generated an estimated overall saving of £1.3m p.a.

In aggregate, there is likely to be less manager turnover which would reduce transaction costs. And combining assets may make it more cost effective for some funds to access certain asset classes (such as private equity, property and infrastructure) where relatively expensive 'fund of fund' approaches are currently used.

However, the changes do mean that individual Pensions Committees will have less control over their underlying investment managers and some compromise will be required across the funds when determining exactly which sub-funds will be made available for investment.

It is anticipated that initial transfers of liquid assets into the pooled vehicle might begin in the second half of 2017 – ahead of the government target of April 2018. The Government has conceded that illiquid investments, such as property, infrastructure, and private equity are likely to transition into the pools over a much longer period of time, and has stressed specifically that investments with significant exit costs should not be wound up early on account of the pooling arrangements.

Within the pool submission in July, individual funds will be allowed to request that they retain specific assets outside of the pool, though it is anticipated that these will only be allowed in exceptional circumstances.

NEXT STEPS

Officer representatives from each of the funds will be working over the next few weeks on agreeing some of the detail set out above. This will need to be reflected in the July submission to DCLG.

The nature of the pool's legal and regulatory structure has been discussed previously and the funds currently intend to proceed with a selection exercise later this year to appoint a third party provider for operating the CIV. Details of the governance process for overseeing the operator are still to be agreed.

The range of sub-funds which will be made available to participating funds needs to be considered and agreed.

Funds have submitted data on their investment costs to CEM Benchmarking, a third party analytical firm, and this will help to set a baseline for monitoring future savings.