

**Wales Pension Partnership
Local Government Pension Scheme Pooling:
Spring Progress Report 2018**

Pool: Wales Pension Partnership (WPP)

Date: 3 May 2018

Criterion A: Scale

- **Scale – please state the estimated total value of assets owned by participating funds**

In our final submission to DCLG in July 2016, we stated that the ambition for the Wales Pool was to create appropriate vehicles for collective investment for all participating funds across all asset classes in time. We can confirm that remains our intention.

The total value of assets of the participating funds referred to in that proposal, valued as at March 2015, was £12.8bn. The total value of assets as at 31 December 2017 was circa **£16bn**.

- **Assets within the pool – please state the total value of assets included in the transition plan for investment through the pool structure, with the valuation date**

The passive investments of the WPP (circa **£3bn-19% of WPP**) are now effectively within the pool. These are held by the WPP authorities in the form of insurance policies. We regard these assets as already forming part of the Pool. The selection exercise for a single manager was carried out on a collective basis in order to derive maximum fee savings from the scale of assets, and the monitoring of the manager and any future retender will be the responsibility of the Joint Governance Committee (JGC).

It may not be feasible for these passive investments to be transferred into the WPP ACS managed by the third party operator as the individual funds will remain beneficiaries of the relevant policies and changing from a life policy vehicle may create additional taxpayer costs without any benefit to justify the change. However, the JGC will review the position on a regular basis.

- **Assets outside the pool – please state the value of assets not included in the transition plan for investment through the pool structure, with the valuation date and the rationale for retaining these assets outside the pool structure**

The funds also have a number of illiquid investments with fixed term lives. It would be very costly to exit from such investments before the planned realisation of the underlying assets. The intention is that the operator will make available pooled vehicles to allow new commitments to be made on a collective basis to illiquid asset classes such as private equity and infrastructure. As the current illiquid investments mature and capital is returned to investors, they will be replaced by new commitments through the new pooled vehicles. These new investments will all form part of the Pool. The JGC may also explore the potential for the operator to carry out due diligence monitoring on the current illiquid investments until they mature.

In addition, the Clwyd Pension Fund has a Liability Matching mandate and a Managed Account Platform, comprising assets in total of approximately **£500m**. Although the Clwyd Fund ISS states that it is committed to investing all assets through the Pool where pooling objectives are met, for these bespoke mandates, it will depend on the capabilities of the appointed operator to accommodate these mandates within the Pool.

OFFICIAL

- **Transition – please state the current transition plan, including:**
 - **the sub-funds that are on offer and planned, with launch dates**
 - **progress on establishing these sub-funds**
 - **timetable for transitioning assets**

Initial ACS sub-funds

After passive investments (already within WPP pooling arrangements), actively managed high alpha global equities is the next largest single liquid component across the combined asset allocation of the participating funds (circa **£3.4bn**). WPP is therefore prioritising high alpha global equities for the initial ACS sub-funds.

The detailed specification of two actively managed high alpha global equity sub-funds has been finalised. A prospectus allowing the two funds to be launched within an ACS structure has been drafted and is expected to be submitted to the FCA in May/June 2018.

Transfers of assets are expected to be carried out in autumn 2018.

Further phases of ACS sub-fund launches

The intention is to initiate work shortly on a sub-fund or sub-funds for active UK equities for launch late 2018 / early 2019, and also begin discussions on the range of bond / credit funds.

Asset class	Timing	Status	31.03.2018 values	
			£bn	% of WPP
Global equity	September 2018	Current Phase	3.4	21
Active UK equities	January 2019	Future Phases	1.6	10
Other liquid assets	May 2019	Future Phases	5.0	31

With the 19% of passive investments included, as stated above, this means that circa 80% of the WPP investments will be within the pooling structure by this time next year.

- **Reporting – please explain how you will publicly and transparently report progress against your transition timetable**

WPP is committed to transparent reporting, respecting normal protocols and constraints in respect of commercially sensitive information.

We will report progress in the first instance to the participating authorities' pension committees and local pension boards who in turn will report progress to their normal stakeholder audiences.

This will include appropriate progress reporting in annual reports for the individual funds and any ongoing reporting required by government or the Scheme Advisory Board.

Criterion B: Governance

- **New functions – please provide an update on the new governance arrangements established/planned and their current status, including:**

The diagram below illustrates the governance structure established by the WPP.

The constituent authorities have committed to the establishment of the WPP through an Inter-Authority Agreement.

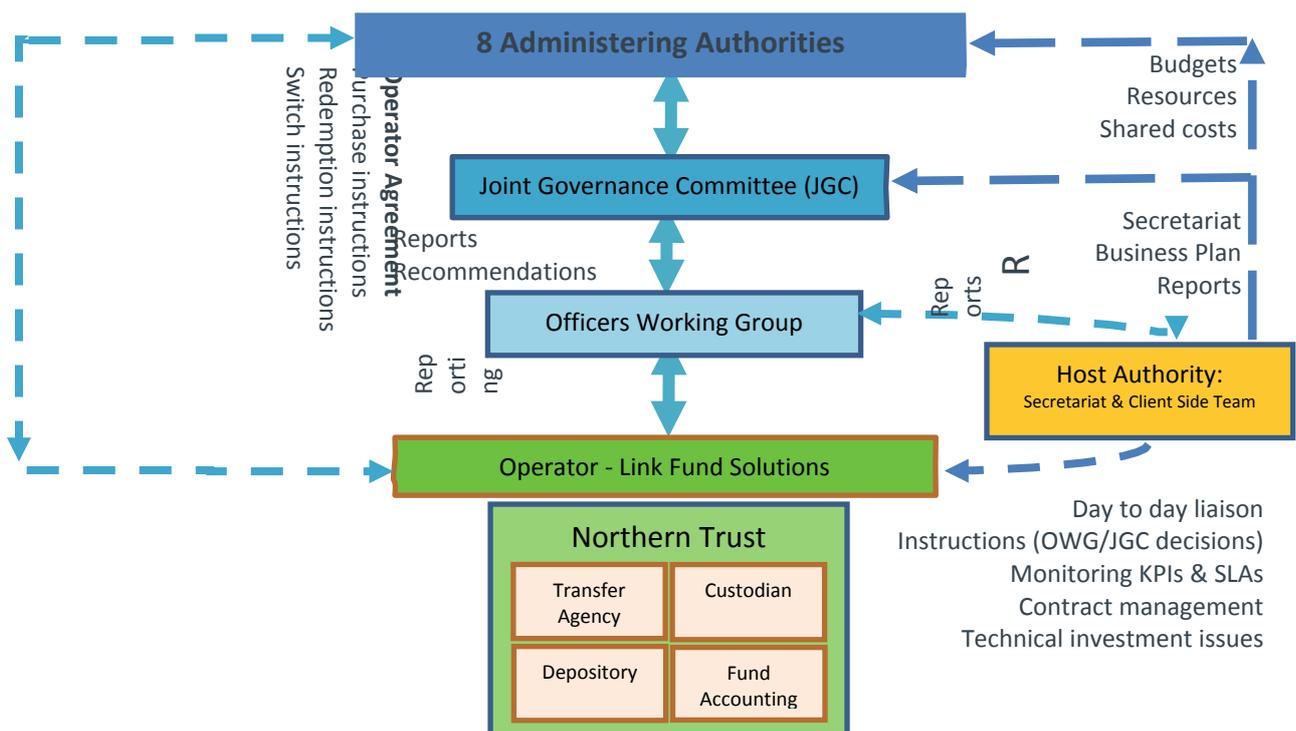
Roles and responsibilities of the Constituent Authorities, Joint Governance Committee (JGC), Host Authority and Operator are summarised in the Appendix.

Carmarthenshire took on the role of “Host Authority” with effect from June 2017.

In summary, the roles and responsibilities of the Host Authority include:

- secretariat functions for the “client side” governance bodies (JGC and Officers Working Group (OWG))
- technical support to the JGC and OWG
- managing the contract with the third party Operator –Link Fund Solutions(LFS)
- preparation of the WPP business plan
- co-ordinating reporting and
- day to day liaison with the Operator and advisors.

Following a procurement process in 2017, WPP appointed Link Fund Solutions (LFS) as the “Operator” of the Pool. The Operator Agreement with LFS was finalised and effective from December 2017.



- **Fund governance (i.e. joint committees or equivalent/related functions) – terms of reference, resources, key appointments, policies and procedures, accountability to elected members, external support/scrutiny, contract management function etc.**

Terms of reference for client side governance groups

The terms of reference for both the Officers Working Group (OWG) and Joint Governance Committee (JGC) are incorporated into the Inter-Authority Agreement (IAA), which was signed and executed by the 8 Constituent Authorities involved in the Wales Pension Partnership in June 2017.

Accountability to elected members

The Operator is held to account by the JGC. As per the IAA, the JGC comprises one elected member from each Constituent Authority. This ensures a direct link to the elected members and pension committees with fiduciary responsibility for the governance of the individual funds participating in pool.

Resources

It has been agreed that the Host Authority will have 2 full time permanent staff initially.

This will be reviewed on a regular basis.

In addition the Host Authority is supported by external advisors including:

- Burges Salmon – legal advisors
- Hymans Robertson – project management and technical support.

Policies and procedures

Required policies and procedures are currently being developed in conjunction with the Operator (LFS) and its Depositary (Northern Trust).

- **Relationship – please provide an update on the relationship between the fund and the pool company, including:**
 - **who makes what decisions (asset allocation, manager selection, custodian selection, etc.)**

Investment Manager Selection

The Operator Agreement sets out the contractual duties of the Operator and governs the relationship between the Operator and the WPP.

The Operator is responsible for:

- appointment of investment managers (IMs)
- due diligence
- entering into investment management agreements (IMAs)
- monitoring and reporting IM performance
- dismissal and replacement of IMs

OFFICIAL

It is assisted in these functions by Russell Investments (RI). RI is a sub-contractor to the Operator (LFS) with capabilities in investment manager research. It was a requirement of the tender process that the Operator should be able to provide these services using in-house capabilities or using a sub-contractor.

Selection of custodian and other support services

The Operator is also responsible for the appointment of, and contractual relationships with, all of the necessary service providers for the establishment and operation of the pool investment vehicles including depositary and custodian services.

Asset allocation decisions

The IAA, which governs the relationship between the 8 Constituent Authorities, sets out that responsibility for decisions relating to individual asset allocation is to be retained by the Constituent Authorities.

For further details please refer to the Roles and Responsibilities Appendix.

- **Reporting and communications - to assure authorities that their investments are being managed appropriately by the pool company, in line with their stated investment strategy**

The Operator (LFS) is contractually bound to provide

- (i) a monthly KPI report which will include details on its performance against specified delivery targets;
- (ii) regular reporting on investment performance at pool and individual fund authority level.

It is also a regulatory requirement that the Operator should monitor adherence by the IM to the investment objectives of the sub-fund it manages as set out in the sub-fund prospectus.

- **Risk management/contingency planning on both sides (e.g. how will changes in fund requirements be implemented , how will unsatisfactory performance be tackled) key contract features (where relevant)**

The Service Level Agreement section of the Operator Agreement includes details of the required timeframes and service standards the Operator must adhere to. This includes procedures and timescales for responding to change requests including sub-fund requirements of the WPP authorities.

The Host Authority will monitor and manage the performance of the Operator on behalf of the JGC. This will include monitoring the adequacy of the Operator's resources.

OFFICIAL

The Operator Agreement includes details of the remediation available to the WPP should the Operator fail to fulfil their obligations under the Service Level Agreement.

In the current establishment phase of the project, project managers within LFS and Hymans (acting for the Host Authority) monitor risks on the Operator and client side respectively. Appropriate mitigation plans are identified and actioned.

- **Transparency – please confirm that the pool company has signed up to the Scheme Advisory Board Code of Transparency**

It is the intention of the Wales Pension Partnership that the Operator will sign up to the SAB code of transparency.

- **Benchmarking – please explain the extent to which benchmarking will be used to assess governance and performance of the fund and the pool company**

Performance of the pool company will be measured against the Service Level Agreement contained within the Operator Agreement.

Investment performance against agreed benchmarks will be monitored by the Operator.

The WPP funds are using CEM Benchmarking for investment cost benchmarking.

Criterion C: Reduced costs and value for money

- **Implementation costs – please state your best current estimate for implementation costs to date and in future years distinguishing set-up costs, transition costs and running costs as far as possible with assumptions and definitions where relevant. Please indicate to what degree costs are on a fully transparent basis in line with the Code of Transparency.**
- **Investment cost savings – please state your best current estimate for investment cost savings to date and in future years, with assumptions and definitions where relevant.**
- **The CIPFA post pooling reporting working group has recently agreed to recommend a draft baseline for reporting costs and savings arising from pooling of 31 March 2015. Please indicate what if any costs or savings before March 2015 are included.**
- **Please also state your best current estimate for the date you will break even.**
- **Where possible please also state total savings on management fees using the draft direct fee methodology presented to the CIPFA working group.**
- **Other benefits and other indicators – please state other benefits of pooling (realised or expected), as well as other indicators of progress (e.g. reduction in the aggregate number of mandates awarded by participating funds, examples of individual savings achieved e.g. through joint procurement of passive management or joint custodian)**
- **Benefits realisation – please explain your plan for achieving (and monitoring the achievement of) savings and other benefits of pooling, while at least maintaining overall investment performance**
- **Reporting – please explain how you will publicly and transparently report:**
 - **transition costs against forecasts**
 - **fees and net performance for each asset class, with a comparison to a passive index for each listed asset class**
 - **savings and other benefits of pooling against forecasts**

Implementation costs

We estimate that the costs involved in setting up the pool prior to March 2018 have been in the region of circa **£1m**.

This includes:

- External legal costs (including legal support on the Operator procurement)
- External project management and administration
- External consultancy support on technical investment matters and Operator procurement
- Host authority costs to date

The stated implementation costs exclude officer time. The costs of setting up the ACS and its sub-funds are being absorbed by the Operator. All of the Operator costs are based on funds under management in the ACS and, to date, are nil.

Transition costs

Transition planning for the two initial sub-funds is due to commence. In the meantime, our estimate of transition costs remain unchanged from earlier reports to government which were **£5.0m to £11.5m** over the next 3-5 years.

OFFICIAL

Estimated cost savings

It has been estimated previously that the reductions in fees for **passive** management have achieved savings are circa **£2.0m** per annum.

Fee negotiations are still ongoing in relation to the two global equity sub-funds due to be launched shortly. However, the Operator has already negotiated material savings from some Investment Managers based on aggregation of assets within the pool. Initial indications are that annual fee savings for the first two ACS sub-funds will be in the region of **£1m** per annum (excluding tax savings) or **£3.4m** per annum (including tax savings).

Discussions on potential fees in relation to other asset classes have not yet begun.

Therefore, our best estimate overall for the level of cost savings from investment manager fees which might be achieved over time remains as set out in our original proposal from July 2016 and the table from the submission is shown below.

Three year period ending	Expected annual savings
March 2021	£8.4m
March 2024	£9.8m
March 2027	£11.3m
March 2030	£12.5m
March 2033	£12.5m

It is important to note that some authorities have already secured very competitive Investment Manager fees and, in some cases, may suffer higher costs on transferring assets to certain sub-funds within the pool since any fee savings will be outweighed by the additional costs of operating the pool (e.g. Operator and Depositary fees). However, it is important to acknowledge other pooling benefits including tax savings and potential for better risk-adjusted future investment returns.

Break-even point

Break even points will vary between funds and will be a function of the level of transaction costs incurred in transferring assets to the pool, individual funds' current fee arrangements and any tax savings which will also depend on current investment approach in individual authority funds (where funds currently use pooled funds there is potential for significant tax savings in the pool's ACS).

However, given the passive savings already achieved, our initial estimates for break even at a pool level remain at 2018-2020 depending on the level of transaction costs incurred.

CEM Benchmarking have been appointed to provide detailed analysis and reporting on cost savings as the pool arrangements are put in place.

Other benefits

In addition to IM fee savings and tax savings there are other scale and pooling benefits.

These include:

- 1) **Tax savings:** There are material tax savings to be gained through all funds moving into a new tax efficient vehicle. The extent of savings will vary across asset classes and will depend on the tax efficiency of the current investment approach used by individual

OFFICIAL

authorities for specific mandates (e.g. those currently using pooled mandates will benefit from a switch to segregated mandates in an ACS structure).

- 2) **Diversification and improved risk-adjusted returns:** Potential for improved future risk-adjusted returns (e.g. pooling enables individual funds to achieve greater diversification by manager than they might achieve on their own at the same time as getting benefits of scale on IM fees)
- 3) **Access to alternative asset classes:** Some authorities may be able to access certain asset classes via the pool that are less easy to access economically without pooling scale (e.g. private equity and infrastructure).
- 4) **Stock-lending:** The move to the pool has provided the opportunity for the WPP funds to re-appraise their policy on stock lending (currently only used by one of the WPP funds). Stock-lending can deliver additional income that is material in the context of operator / depositary fees and can help offset the additional costs of pooling.

Reporting

The Operator will be required to provide WPP with all of the data on cost savings, transition costs and investment performance needed by the JGC and by individual authorities and required to comply with all relevant external reporting requirements.

Criterion D: Infrastructure

- **Status – please state the current allocation to infrastructure at participating funds and how much is currently committed**
- **Ambition – please state the current ambition of the pool for infrastructure investment with timescale**
- **Progress – please explain how pooling has increased capacity and capability to invest in infrastructure, or is expected to, including:**
 - **the platform/product/external manager arrangements that are being used or are intended to be used**
 - **indicators of progress made to date (e.g. mandates awarded, specialist appointments at pool companies, examples of investments made)**

Ambition

Our stated ambition remains as set out in our original submission from 2016, namely - in the short to medium term - to have at least 5% of assets invested in infrastructure investments with a longer term aspiration set at 10% - subject to satisfactory investments being available.

Current allocation

A total of circa **£200m** is either invested in infrastructure assets or formally committed to infrastructure funds, equivalent to circa 1.2% of pool assets, so the stated target represents a significant increase from the current position (potentially a five to ten-fold increase).

However, we also acknowledged in our original submission that allocations to infrastructure represent asset allocation decisions and are therefore the responsibility of individual funds rather than a collective decision for the Pool.

Approach to infrastructure investment

We have opened discussions with the appointed operator and adviser as to the options available for accessing infrastructure investments through the pool. It is intended that one or more pooled vehicles will be made available for funds to make commitments to investment in the asset class. In addition, the WPP has commissioned a report from a third party consultant on how infrastructure assets might be accessed on a collective basis. The OWG have also arranged a presentation on a specific local Infrastructure project.

We are also aware that the most efficient way of accessing infrastructure investment suitable for LGPS fund liabilities might be through national vehicles, e.g. GLIL, developed for use by the funds and pools. We therefore continue to engage with and support the work of the cross pool infrastructure collaboration group in order to ensure that we may benefit from any national initiatives which may emerge in the future.

Appendix - Roles and Responsibilities

Constituent Authorities / Individual Funds

In addition to managing its own liabilities, setting its own employer contributions and administering its pensions:

- Investment strategy decisions
 - Strategic asset allocation
 - ISS/FSS
 - Investment beliefs
 - Delegation of investment manager decisions to the Pool
- Monitoring/reporting
 - Monitoring investment performance of own portfolio
 - Challenge pool if investment managers are underperforming
- Governance
 - Holding pool to account (e.g. if not happy with sub-fund performance, request review)
 - Providing representation on the JGC and OWG
- Operational/BAU
 - Timing of own transitions (initial and ongoing) and switches between sub-funds
 - Custody for non-pooled assets
 - Instructions to invest, redeem, switch in or between the pool sub-funds
- Policies*
 - Rebalancing policy
 - Responsible investment
 - Voting policy
 - Stock lending – what is in/out – existing/future
 - Policy/rules for investment in infrastructure
 - Currency overlay strategy

* WPP will consider the extent to which some policies or guidance should apply at pool level in order to avoid, where possible, the creation of additional sub-funds to accommodate different policies.

Joint Governance Committee Responsibilities

- Governance
 - Conform with IAA (joiners/leavers/cost allocation)
 - Hold Officer Working Group (OWG) to account
 - Oversight of all assets under pool governance (including passive investments)
 - Strategic planning, resourcing plan, business plan and budget for WPP
- Operator relationship
 - Agree specification for Operator and oversee procurement
 - Recommendation on 3rd party Operator to Constituent Authorities
 - Monitor performance of Operator
 - Recommend termination of the Operator, extension or new supplier to Constituent Authorities at end of contract
 - Input to consultation by the Operator on matters such as reviews of Investment Managers and asset transition plans
 - Agree any changes to the Operator Agreement, SLAs or agreed practices, procedures and protocols (“change control”)
- Decisions at pool level
 - Instruct Operator on initial sub-fund and mandate requirements
 - Instruct Operator to establish additional sub-Funds or terminate existing ones
 - Instruct Operator on requirement for any non-ACS pooling vehicles
 - Approve high level transition plan proposed by Operator
 - Decisions on how to access infrastructure
 - Agreeing any common policies (e.g. stock lending/voting)
 - Decide other advisors and suppliers to the WPP
- Communications e.g. government and civil servants, press, etc
- Value for money

Host Authority & Client Side Team

- Secretariat to Joint Committee
- Lead on procurement for pool services (e.g. advisers, etc.)
- Client side team for:
 - Operator contract management
 - Monitoring performance of Operator against SLAs and KPIs
 - Day to day liaison with the Operator and its provider of establishment, consultative and non-consultative services, especially on matters affecting all funds / investors in the pool
 - Liaison with other advisers
 - Reporting Operator performance to the OWG and JGC
 - Executing and reporting progress on the Business Plan agreed with the JGC and OWG
 - Other analysis, support and reports for the OWG and JGC as required.
Examples:
 - options for accessing alternatives / illiquid assets including infrastructure
 - pool policies on ESG
 - implications of regulatory change and required action e.g. MiFID
 - options at end of Operator contract – extend, re-tender, build and own
 - Client side team will NOT be middle man for all instructions to the Operator from individual administering authorities (investors and clients of the Operator) e.g. payments into the pool's investment funds, redemptions, switch instructions can all go directly to the Operator

Operator (Link Fund Solutions) Responsibilities

Core responsibilities

- Establish and operate an ACS and sub-funds for the sole use of the WPP LGPS funds
- Obtain all necessary regulatory approvals
- Fund administration
- All regulated functions and reporting
- Appoint and contract with investment managers
- Select and procure asset servicers (transfer agent/ depository/ custodian/ accounting)
- Propose sub-fund structure
- Manager monitoring and review and manager searches and recommendations (working with investment advisors)
- Asset transition management
- Implementing individual fund rebalancing policy