ASSISTANT CHIEF EXECUTIVE RESOURCES
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Chris Megainey
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Dear Chris,

Society of Welsh Treasurers-Pensions Sub Group
Collaborative Working

I write on behalf and with the agreement of the 8 Pension Fund Treasurers in Wales in respect of the work taking place around collaboration and pooling of investments. The group recognises the requests thus far from Ministers and from DCLG in respect of pooling discussions and seeking improvements in efficiencies and economies and has been participating in the wider debate on these matters wherever possible.

Whilst recognising that further details may emerge this month around Ministers' expectations for such collaborative proposals, the Welsh group wanted to ensure you were fully aware of, and sighted on the current work that has already taken place in Wales.

In summary, we are currently moving forward with two projects. The first is a joint procurement for our passive investments, which account for about a quarter of our total assets, and we anticipate will be in place before the end of the financial year. The second is the larger project to enable us to invest collectively across other asset classes, which we anticipate could be operational around the end of 2016/17, or shortly therafter. We have concluded that this is the optimum solution for Wales based on research and evidence from various sources over a number of years. To assist you with an understanding of why we have come to this conclusion I have set out below further details on the background, timeline, research and next steps

Background in Wales

Collaboration across the 8 LGPS pension funds in Wales is not new. Opportunities for networking have always been utilised at both Chief Officer and Practitioner level given the specialist nature of the function involved. This has for a number of years been illustrated more overtly through networking and communications mechanisms such as the production of an All Wales Annual Benefit Statement provided to scheme members for a number of years.

More recently in Wales the benefit of closer collaboration is now making progress having begun with the Society of Welsh Treasurers (SWT-Pensions Sub Group) commissioning a report from Price Waterhouse Coopers that was published in October 2010 on whether there was a case for closer collaboration or even merger across functions or funds to support the longer term affordability and sustainability of the Welsh Funds. This has universal support from all 8 Pension Committees.

In a broader national and also Welsh context, subsequent steps included:

- **10th March 2011** Final Hutton Review Report
- DCLG consultations on the "new " LGPS scheme

2013

- **March 2013**-SWT Working Together Outline Business case(incl. stakeholder consultation)This report concluded that collaboration rather than merger was the way forward and that the greatest benefit would be in respect of investments rather than administration or governance structures.
- **Oct 2013**- Invitation by SWT for consultants to prepare options and then full business case
- **Nov 2013**- Tenders received and evaluated
- Preferred consultant identified but "Imminent" DCLG announcements on future direction deferred progress until "direction of travel" was clear

Sept 2014

- DCLG Cost savings and Efficiency consultations(incl. passive vs active debate)
- DCLG Governance consultations(introduction of pension boards by April 2015)

2014

- London collaborative initiative and development of Collective Investment Vehicle
- Other collaborative initiatives in SW England, together with Pensions Administration initiatives in London and South East
- Use of Frameworks for consultancy, actuary's etc... led by Norfolk for a national framework together with some other regional examples
- WAO value for money review in Wales of the LGPS

May 2015

- SWT commissioned report on Full Business Case published
- WG commissioned report published by WAO/PwC
- July Budget announcement that *"The government will work with Local Government Pension Schemes 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 plans are required to pool"*

It is recognised that the Government expect efficiencies and savings through collaboration and pooling, and if Local Government ideas and proposals do not go far enough, Government will have powers to prescribe the blueprint to be followed.

Building on the chronology above, the clear desire however within Wales is to continue the direction of travel we have adopted to date which we believe accords with Central Government expectations whilst recognising the physical geography and economic and political context within Wales.

The Current Welsh Position

The SWT have continued to make steady progress in assessing the potential for collaboration in Wales around investments and what form that might take. In 2015, a key step has been the commissioning of a detailed report from Mercers. The purpose of the report was the development of a detailed business case for the establishment of a common investment fund for the eight current Welsh Pension Funds. The vision behind this was to create a vehicle to maximise efficiencies (both in investment fees and investment returns) by having participants' investment needs optimised through such a vehicle, as previously demonstrated in earlier reports.

The report was produced by Mercers (available on request) who were also tasked to:

a) identify how in practice such an arrangement can be implemented;
b) refine further the financial savings and costs that could be anticipated; and
c) identify any practical difficulties which would need to be overcome.

The Executive Summary version of the report is attached for ease of reference but their final recommendations fully endorsed and agreed across all 8 Welsh Funds included the following:

a) Pursue a collaborative approach in order to avail of key benefits that include economies of scale and reduced costs, increased consistencies, enhanced governance and operational management across the Welsh Funds.
b) Select a single passive provider for passive global equities to obtain immediate cost savings. (A pooling structure would not be required to achieve these gains)
c) Establish a pooling framework to extend collaboration beyond passive global equities
d) Adopt a regulated pooling vehicle along with a model that supports leveraging the infrastructure of a third party provider (rather than building such infrastructure internally).In addition, the paper suggests that the Welsh Funds look to appoint a provider with appropriate experience who can provide an optimal level of governance and operational support, reducing both the risk and cost of developing internal resources and capabilities to operate the new framework.
e) Agree a set of next steps to take forward the project, including a workshop/training session and development of a project plan, including the potential tender process to assess suitable partners/providers to support the new collaborative framework.

A further meeting of the SWT Pensions Sub Group in June 2015 agreed the essential next steps were to:

a) Fully engage elected members on Pension Committees to bring them up to date with reports to their next meetings in September.

b) procure an advisor/strategic partner to appoint a provider with appropriate experience who can provide an optimal level of governance and operational support, reducing both the risk and cost of developing internal resources and capabilities to operate the new framework.

c) establish a sub group of investment officers to look at a single passive provider for passive global equities to obtain immediate cost savings.

In parallel to these steps, under the auspices of the Welsh Governments Workforce Partnership Council, the Wales Audit Office initiated at the request of Welsh Government a value for money review of the Welsh LGPS very early in 2015. The project brief was short as follows:

To provide an independent review of the benefits, risks and issues of merging – if that were in future to provide possible – local government pension scheme funds in Wales (into either a single or small number of funds), over and above changes already being considered to improve their governance and administration.

This review should draw on existing studies and information sources, as well as being informed by discussions with relevant experts and stakeholders, (e.g. Welsh local government pension fund administrators, the Society of Welsh Treasurers, recognised local authority trade unions)

The report was researched and drafted with the support of PwC and stakeholders groups as referred to in the Brief were engaged as part of the final stages of production of the report. The report was submitted to Welsh Government in May with the following key recommendations:

a) There is a strong case for the Welsh Government and the Welsh Local Government Association to support the establishment of a CIV for all eight funds in Wales. This approach would incur start-up costs, and the Society of Welsh Treasurers should be asked to provide analysis of those costs.

b) A Wales CIV could be established over the next two years, in advance of local government reorganisation on the assumption of appropriate commitment by relevant stakeholders including the funds themselves/existing administering authorities.

c) Following local government reorganisation, participation in the CIV, by the eight administering authorities responsible for the funds, should be reviewed. If participation in a CIV was not at an optimal level to secure the maximum investment returns after a pre-determined time period, then the Welsh Government should consider merging the existing eight funds into a single LGPS fund for Wales using an appropriate legal channel.

d) There is also a strong case for considering further either an earlier merger of the eight funds in Wales or, if available, a joint committee approach. These possibilities might create more investment efficiency than a Wales CIV but are not within the sole control of the Welsh Government. The latter would depend on recommendations by the LGPS Scheme Advisory Board (SAB) and both would depend on decisions by DCLG.

e) These recommendations have to be considered in the light of the wider considerations taking place. For example, DCLG's forthcoming response to the consultation, which may result in optional or mandatory participation in CIV(s) and

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advice given by the Governance and Standards Sub-Committee of the SAB, which may open up a joint committee route for the eight funds in Wales. Accordingly, given the state of flux shortly after the General Election, these recommendations are highly time sensitive and actions should be taken only after further consideration.

In essence, the direction of travel of this report is supportive of DCLG pronouncements but also the direction already embarked upon by the SWT. It does however add emphasis at a Welsh level to the momentum already created at national level.

Next Steps

Since the publication of these reports and the further DCLG requirements, all 8 Welsh Pension Funds have taken a report to their Pension Committees in September and agreed:

i. to progress a procurement process for the selection of a single passive provider for passive global equities to obtain immediate cost savings. This process has now started.
ii. To establish a pooling framework (a collective investment vehicle) to extend collaboration beyond passive global equities
iii. To appoint an external advisor to advise the Funds in sourcing a CIV provider with appropriate experience who can provide an optimal level of governance and operational support, reducing both the risk and cost of developing internal resources and capabilities to operate the new framework. An advert is out to tender at present for the advisor. (http://www.sell2wales.gov.uk/search/show/search_view.aspx?ID=OCT107695)

The Government's expectations are clearly understood in Wales and have been echoed and emphasised by the WAO report commissioned by Welsh Government. However notwithstanding more recent announcements and not wishing to pre-judge ministerial direction, the Welsh Funds want to ensure that DCLG had sight of the progress that has already been made in Wales and the robust proposals already in train. There is a clear intent and momentum in developing a Welsh solution capable of achieving efficiency and cost savings in respect of pension investments.

The Welsh Pension Funds believe that the approach being followed will:

- Produce benefits in a relatively short timescale given the work, analysis and results previously produced and with political agreement across the Funds in Wales on the direction of travel already in place
- Achieve savings that could be "significant" and that could sensibly be translated into a meaningful service equivalent for local government services and thus value for money in Wales.
- Enable governance arrangements that are manageable and practical so that the pooling proposals remain related to the locally administered funds and show a level of clear accountability to local decision making.

I apologise for the length of this correspondence but all 8 Welsh Funds deemed it important to set out the current position but also the journey travelled thus far.

Please let me know if you wish to clarify anything at this stage or you require further details.

Yours sincerely

[redacted]

Graeme Russell
HEAD OF HUMAN RESOURCES AND PENSIONS

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