

Local Government Pension Scheme - Statutory guidance on asset pooling

Introduction

The 8 LGPS Administering Authorities of the Wales Pension Partnership (WPP) are pleased to be able to provide this response to the Government's consultation on revised LGPS pooling guidance. The Authorities hope that the Government finds it helpful to receive a single consolidated response from WPP on the key points it has identified from the consultation, which further underlines WPP's effective partnership approach.

We welcome the intention to set out an up to date list of requirements on a statutory basis, to establish common terminology and to clarify the position on questions raised by funds and pools.

Firstly, it needs to be emphasised the importance of achieving value for money when making investment decisions. This is clearly linked to asset allocation strategies and the responsibility for meeting liabilities and hence asset pooling should not detract from the Funds' responsibilities and accountability for achieving this.

Structure and definitions

The Government should ensure that the guidance takes account of the variety of pool operating models, as it currently appears to be largely written for the circumstance where 'pool companies' are wholly owned by the pool members, rather than the 'pool company' being a third party awarded a contract by the 'pool members'. Paragraph 3.2 correctly states that 'pool members' may appoint more than one pool company. The guidance should recognise more clearly that multiple 'pool companies' may be appointed to provide

'pooled vehicles/funds' to the 'pool members' and to provide the investment management of those assets. This could include passive investments through life funds, or infrastructure and other illiquid investments. This is no different to the provision of internal investment management by wholly owned 'pool companies'.

WPP feels that MHCLG needs to reconsider its definition of pooling to ensure consistency and any undue misunderstanding. WPP believes that MHCLG has correctly referenced CIPFA's definition of 'pooled assets' (key sections have been underlined) *'those for which implementation of the investment strategy – i.e. the selection, appointment, dismissal and variation of terms for the investment managers (including internal managers) – has been contractually, transferred to a third party out with the individual pension fund's control'*. However this is not consistent with the definition in the draft guidance *'an investment for which the selection, appointment, dismissal and variation of terms for the investment manager is delegated to a regulated pool company, or an investment held in a pool vehicle'*.

As an example MHCLG is aware that the WPP authorities have let contracts to BlackRock for the management of WPP passive investments, which have saved at least £2m per annum, and for which WPP have been complimented many times by the Minister. We have therefore assumed that the Government would want to treat these savings as a pool saving. The decision on the award of these contracts was made by the WPP and the ongoing management of the contract and investments will be under the pool's governance, not individual authorities, thereby meeting CIPFA's definition, and as such will be reported as a 'pool asset', which should be reflected in the guidance.

Active and passive investments

The WPP authorities are pleased that the guidance continues to reflect that strategic asset allocation remains the responsibility of individual administering authorities. As such the decision to invest in active or passive investments will be determined by each administering authority based on their individual assessment of the suitability of the investments and approach to risk [Regulation 7(2) (b & c)] in their Investment Strategy Statement. The effectiveness of both active and passive investment is already being closely monitored by each authority as part of the ongoing management of their pension fund.

The decision to invest in either active or passive investments is not a pooling issue and therefore paragraph 3.6 should be removed from the guidance. However, if this section is to remain in the guidance, it is important that any assessment of performance takes into account the level of risk being taken to achieve this performance. The lack of reference to risk is a notable omission in the draft guidance.

Local Pension Boards

Each administering authority established a local pension board under the provisions of Section 3 of the Public Service Pensions, England and Wales The Local Government Pension Scheme (Amendment) (Governance) Regulations 2015. It is responsible for assisting the administering authority and performs an oversight role, to

- Secure compliance with the LGPS Regulations and any other legislation relating to the governance and administration of the Scheme and any other connected scheme, and any requirements imposed by the Pensions Regulator in relation to the Scheme and
- Ensure the effective and efficient governance and administration of the Scheme.

Therefore whilst not having a direct role in investment decisions we recognize the pension board alignment to pension funds through their assisting role hence they do have an interest in pool governance, regulatory control and on how funds are holding pools to account.

Value for money and holding assets outside of the pool

The WPP funds are disappointed that the original pooling criteria of 'value for money' does not continue to feature in the guidance. The guidance correctly identifies that *'Members of Pension Committees are elected representatives with duties both to LGPS employers and members, and to local taxpayers... [and] have legal responsibilities for the prudent and effective stewardship of LGPS funds'*. While the guidance states that *'LGPS benefits are not dependent on their [local pension committees'] stewardship'* critically the cost of those benefits to scheme members are, therefore the value for money of each funds' and pools' investment arrangements remain important and a key part of the discharge of pension committees' fiduciary duty, and should remain a fundamental pooling criteria.

Paragraph 4.4 of the guidance correctly refers to pension committees and pool governance committees taking a long-term view of the costs and benefits of pooling. However in going further and stating that there should be consideration 'of the benefits across the pool and across the scheme as a whole', it sets inappropriate and unworkable expectations. Individual pension committees have a fiduciary responsibility to their own scheme members and cannot make decisions that disadvantage their own fund, even if it would benefit others. There is no mechanism for pools to quantify benefits to the scheme as a whole, and this is an unreasonable basis for pool decision making. The section of paragraph 4.4 quoted above should be removed unless the Government can provide a legal opinion that shows Administering Authorities fiduciary duty must extend external to their pool and the scheme as a whole.

Since the original pooling guidance in 2015 WPP's significant work around pooling has identified that there are net savings that can be achieved through pooling in investment managers fees and costs. This has been reported to the Government and been received positively. The WPP has also reported that it has a programme of work to implement pooling and achieve these savings, which is already well underway.

Nonetheless the work to date has also highlighted that in a number of instances individual authorities have already achieved very competitive fees, and in some instances little to no further saving can be achieved through pooling, which is recognised in the guidance in paragraph 5.4. However, the guidance should acknowledge that despite regular review,

the on-going benefits of pooling over the long-term may never outweigh the costs and assets may remain outside of the pool indefinitely. As such the heading for paragraphs 5.4 and 5.5 should have word 'temporary' removed and the definition of a 'retained asset' should be amended to 'an existing investment allocation retained by a pool member'. Further clarification on the retention of assets outside the pool must be included, in particular with regards to direct property investments. Unlike other asset classes, direct property will not 'mature' (as described in paragraph 5.4) and ultimately become available for investment in a subsequent pooled solution. In addition to maximise investment returns and for efficient portfolio management new direct property investment will continue to be made within existing strategic allocations, whilst new allocations will be made within the pool when suitable options are available.

Making new investments outside the pool

We welcome 6.2 investments in local initiatives. The WPP sees these as important potential investment opportunities which are currently being considered.

Reporting

As stated earlier in this response the Government must ensure that this guidance reflects both pooling models where the 'pool company' is a third-party provider or wholly owned by the pool members. As such paragraph 8.8 should either be deleted or clarified that it only applies to wholly owned pool companies. Third-party pool companies will not produce annual reports that are relevant to LGPS investment pooling.

The preceding paragraphs of section 8 are correctly worded. WPP's contract with the operator ensures that it reports to the pool members in line with the SAB Code of Cost Transparency (paragraph 8.7), which will be the basis of the administering authorities annual reports produced in accordance with CIPFA's guidance, which can be collated by the SAB (paragraph 8.6).

Responsible investment

The consultation is notably light on wording in this area. Given the importance of this subject, we believe there is scope for wording on this subject, and the potential implications of pooling, to be added to the guidance.