ITEM NO: 8

Report To:	**Pension Fund Management/Advisory Panel**
Date:	2 October 2015
Reporting Officer:	Peter Morris, Executive Director of Pensions
Subject:	**LGPS UPDATE**
Report Summary	There are two major pieces of work currently being undertaken that could have a very significant impact on the structure and delivery of the LGPS. These are: (i) Options for Separation of duties between funds and their host authority – a report commissioned by the Scheme Advisory Board; and (ii) Pooling of Assets – a process introduced by the Chancellor in his Summer Budget. The purpose of this report is to comment on both these items and seek the Panel's initial views on response to Pooling of Assets.
Recommendations:	(i) To note the position on Options for Separation; and (ii) To consider the Fund's initial response on Pooling of Assets and an appropriate process for approving any additional expenditure required at short notice.
Policy Implications:	None.
Financial Implications: (Authorised by the Section 151 Officer)	At this stage, it is not possible to quantify the short and long term implications of possible outcomes from the review of the Options for Separation or Pooling of Assets. The motivation for pooling of assets is to improve net investment returns in the long term.
Legal Implications: (Authorised by the Solicitor to the Fund)	It is likely that regulatory changes would be required to implement material proposals arising from consideration of these issues.
Risk Management:	The Options for Separation review is centred around the issue of conflicts in the LGPS and how these can be managed. The aim of pooling of assets is to improve net investment returns. The Fund is working with other funds with support from Hymans Robertson to evaluate some of the options as part of the evidence to be put to Government.
ACCESS TO INFORMATION:	**NON-CONFIDENTIAL** **This report does not contain information which warrants its consideration in the absence of the Press or members of the public.**
Background Papers:	For further information please contact Peter Morris, Executive Director of Pensions tel 0161 301 7150, email peter.morris@tameside.gov.uk.

1 INTRODUCTION

1.1 There are two major pieces of work currently being undertaken that could have a material impact on the structure and delivery of the LGPS in the future. When set in the context of the current volatility in financial markets and funding levels this may well be a pivotal time for the LGPS.

1.2 The Scheme Advisory Board has commissioned KPMG to produce a report on Options for Separation of duties between funds and their host authority. The purpose of this report is to set out the options and comment thereon.

1.3 The Chancellor in his Summer budget, made an announcement on pooled investments. The progress to date will be considered in this paper.

1.4 The role of the Local Board, the Options report, asset pooling and managing deficits all interact in the delivery of LGPS governance arrangements.

2. OPTIONS FOR SEPARATION

2.1 KPMG's remit was to analyse three options for increasing the separation between the operation of funds and their host authority, there were:

Option 1 – Stronger role for S151 Officer / Pension Manger within a distinct entity of the host authority;
Option 2 – Joint committee of two or more administering authorities; or
Option 3 – Complete separation of the Pension Fund from the host authority.

2.2 Currently administering authorities adopt a variety of approaches, ranging from pension operations being part of Finance (which is the norm for many funds) and other functions to discrete, standalone pension units. GMPF is a good example of Option 1, South Yorkshire Pension Authority operates broadly in line with option 2 and LPFA is an example of Option 3.

2.3 The review is centred around the issues of conflicts in the LGPS and how they can be managed.

2.4 In undertaking their review, KPMG have interviewed a number of stakeholders. GMPF was the first fund that they interviewed and the Fund was represented by the Chair, Director and an Assistant Director. KPMG used a standard questionnaire.

2.5 KPMG were asked to assess the options against criteria established by the Scheme Advisory Board, the criteria were:

(i) the end position, together with the steps required to reach that position;

(ii) the impact (positive and negative) on the accountability of the Scheme Manager to Scheme members, employers and local tax payers;

(iii) the impact (positive or negative) on compliance with IORP Directive and in particular comprehensive and clear accounts, dedication of resources, management and administration costs and investment costs;

(iv) the ease or complication of the legislative requirements to implement the option;

(v) the impact (positive and negative) on management costs and funding or investment costs;

(vi) the impact (positive and negative) on service delivery to stakeholders, (scheme members, employers and third parties such as the Pension Regulator and HMRC).

2.6 The Fund's representation to KPMG was strongly in support of Option 1. The case was based on:

(i) our experience gained from operating in line with Option 1;

(ii) the scope for broad governance arrangements and the involvement of 10 other employers significantly reduces the scope for conflicts between the host authority and the Fund;

(iii) value for money;

(iv) track record.

2.7 The next stage will be KPMG submitting and presenting their report to the Scheme Advisory Board.

3. POOLED INVESTMENTS

Background

3.1 DCLG/HMT have been looking at options to reduce investment management costs and improve investment returns for a number of years. A recent example was consideration being given to the case for all funds to adopt a passive investment management approach to reduce investment management costs. The case for fewer funds has also been considered in the past.

3.2 The announcement by the Chancellor in the summer budget seeking proposals for pooling of assets by funds is a major issue for the Management Panel to consider and respond to.

3.3 The Scheme Advisory Board considered a progress report on this matter at its meeting held on 21 September 2015 and a copy of the report is attached at **Appendix 1**. The paper includes key messages, a brief note of the meetings held and a description of the options for pooling.

- Key Messages from the Government/Scheme Advisory Board Report.

3.4 Since the budget announcement the following key messages have emerged in discussions with DCLG/HMT officials:

a) Proposals for pooling will need to be assessed against criteria to be set by government. The budget statement is potentially misleading in that the consultation on the criteria is happening now (through a series of roundtable meetings) and not in the autumn.

b) Criteria are likely to be around size (£30bn has been used as an illustrative example), cost/savings and governance (improving decision making such as hire/fire decisions of fund managers). However there will be no specific savings target in the cost criteria.

c) In the autumn, the criteria will likely be published alongside a consultation on:
   - new investment regs (prudent person?); and
   - 'back stop' legislation which will apply if any fund is not invested via a vehicle/s which meet the criteria;

d) Thoughts about pooling models and options should be underway now with a view to options going to ministers early next year.

e) Announcement by government on the way forward likely in Spring 2016.

f) Asset allocation is to be left at the local level, but as yet there is no guidance on the exact nature of this allocation (e.g. at the asset class or sub class level?)

g) Government has no fixed ideas on the structure of pools (Collective Investment Vehicles, Framework, joint procurement, etc).

h) Government has no fixed ideas on type of pools (regional, multi asset or single asset) but has expressed a preference for a 'simple' solution.

i) Government is alive to the transition issues for example illiquid vehicles that cannot be unwound in the short term without significant financial penalties. It is also aware of the time that structures such as the London CIV have taken to set up. However it will probably expect pooled vehicles to be in place in this parliament even if all assets are not yet ready to be moved.

j) There may be a place for a proportion of the assets to remain under direct local control in certain circumstances. However any such exemptions would probably be for prescribed investments and will be small.

3.5 Meetings have been held by the LGA with funds and investment managers. Funds are starting to give consideration to the issues and the scale of change being sought by DCLG in the governance of their funds. For example a suggested outcome could be that funds retain responsibility for asset allocation and the decision on active or passive investment management but do not individually pick active managers. A note of the Q & A from a meeting with funds is attached at **Appendix 2.**

3.6 The investment managers' views were that the greatest cost savings would be obtained from funds presenting themselves as one client with decision making placed within the pools.

3.7 The SAB report also considers:

(i) potential models;
(ii) structures for implementing the pools;
(iii) proposals for further work:
- comparative study on the size related benefits of multi-asset pools;
- methodology for comparing gross investment costs;
- suitability of a fixed liability matching pool.

4. CRITERIA FOR EVALUATING POOLING OPTIONS

4.1 Simplistically, there are two ways in which assets can be pooled:

(i) By funds working together and pooling their collective assets, and
(ii) By creating individual asset class pools, e.g. a UK equity pool.

An initial evaluation of these options will be presented at the Panel.

4.2 The Government is currently looking to determine the criteria by which the options are evaluated. It has flagged scale, cost savings and good governance as being part of the rationale for this initiative. The following are suggested as potential criteria:

(i) The improvement in net investment returns. This will be a function of investment cost and return on investment.

(ii) The suitability for meeting individual employer needs where maturity of liabilities and funding level will vary materially between employers (and funds). The challenges facing funds and employers have been frequently discussed at the Panel and how a fund delivers stable and affordable employer contributions on a prudent and transparent basis is key.

(iii) From the GMPF perspective, the scope to invest locally with the twin aims of commercial returns. This could be extended to include supporting UK infrastructure again with the twin aims and having the capacity in the medium term to compete with large foreign funds.

(iv) The ability to undertake corporate governance activities.

5. ACTIONS TO DATE

5.1 Fund representatives have attended meetings held by LGA and DCLG.

5.2 Metropolitan fund meetings (plus some other in-house managed funds) have been arranged and attended. A differentiator between GMPF and other metropolitan funds is that we are at the lower end of the range for in-house management (and at the upper end of the range for external management) of our securities portfolios.

5.3 GMPF is collaborating with a number of funds supported by Hymans Robertson to evaluate a number of options against the following criteria:

- Size - are the multi asset pools sufficient to meet the assumed government criteria of £30bn, are the other vehicles optimally sized for their class or method?
- Costs - what are the estimated gross savings for each option?
- Governance - how do each of the models provide political structures and behaviours that encourage best practice outcomes (e.g. long term investment)?
- Local political direction - who is working with who already, where are the obvious fits
- Central political direction - are there other policy drivers which the options best fit with (e.g. combined authorities)?
- Impact on competition - both in the manager market and between pools.
- Legislative requirements - what is needed and what would be the time frame needed?

5.4 The Fund is represented on the Steering Committee of this group, it is also leading the workstream on what flexibility should be allowed for investing outside of pools and contributing to the property, infrastructure and other alternative investments. A note from Hymans Robertson is attached at **Appendix 3**.

5.5 Informal discussions have been held with a small number of other large funds.

6. SUMMARY AND CONCLUSIONS

6.1 The interaction of the austerity programme and the economic environment means that funds are rapidly maturing and funding levels are at historical low levels. The potential outcomes from managing deficits, the options for separation and pooling of assets could lead to fundamental reform of the structure of the LGPS and its governance arrangement. It is likely that there will be no exemptions from pooling for the vast majority of Fund assets and an end to local decision making on manager selection.

6.2 The scale of GMPF, its long term track record and the experience gained from the take on of probation liabilities places it in an excellent position to contribute to the debate. This can take varying forms, such as responding to government consultations, trying to develop an effective consensus view with others, e.g. through the holding of an event for LGPS funds to develop views, commissioning research and obtaining legal advice. This may also incur additional costs outside the existing budget. Given the exceptional circumstances, approval of additional spend may be needed at short notice.

6.3 The first issue is to contribute to the consideration of criteria for evaluating options. Proposals are set out in section 4 of the report.

6.4 The collaboration of funds supported by Hymans Robertson to evaluate options is likely to be influential in future decisions. GMPF will have significant input into this work.

6.5 There are many stakeholders that will have an interest in the outcome of this exercise. Structured discussions with other funds need to be progressed.

6.6 It is likely that urgent matters will arise as this process progresses. The norm will be to use existing governance arrangements (Panel and Working Groups) but there may also be a need for Urgent Matters meetings.

7. RECOMMENDATIONS

7.1 To note the position on Options for Separation.

7.2 To consider the Fund’s initial response on Pooling of Assets and an appropriate process for approving any additional expenditure required at short notice.