

Local Government Pension Scheme pooling: autumn progress report

Please report against each of the areas outlined below as at 30 September 2017, highlighting significant changes to your final proposal submitted in July 2016, and/or since the last progress update report submitted in April 2017.

The deadline for submission is Friday 20 October 2017. We will follow up any questions or concerns with individual pools as necessary.

Pool: Northern Pool

Date: 30 September 2017

Criterion A: Scale

For pools in development

- **Scale – please state the estimated total value of assets included in your transition plan for investment through the pool structure, with date of estimate**

No material changes to July 2016 submission – equivalent to approximately £42bn at 31 March 2017

- **Assets outside the pool - please state the estimated total value of assets to be invested outside of the pool structure by participating funds**

No material changes to July 2016 submission – approximately 1% of pool assets (c£400m at 31 March 2017)

- **Progress towards go live by April 2018**
 - **please provide an updated high level project plan to achieve delivery by April 2018 including progress with operator procurement/build, design of sub funds, recruitment of core team, appointment of depository and FCA authorisation**

Please see Appendix 1 attached which sets out the further work to be undertaken up to April 2018.

A Pool custodian will be in place before 1 April 2018 to ensure all listed assets of the pool (i.e. internally and externally managed equities and bonds) are held within a single permanent FCA regulated entity. Procurement of this custodian is progressing well with the shortlist down to 3 bidders and site visits taking place in the first week of November.

The scope of the FCA Regulated pool custodian will be extended beyond a LGPS custodian's typical remit, reflecting the particular challenges and opportunities of the pooling agenda. For example, the custodian will be used to manage the calls and distributions in the Northern Pool private equity vehicle which is under development (with an expectation that collective private equity investments will be made with

effect from 1 April 2018) and the custodian's analytical capabilities will be used to enhance the Pool's performance and risk reporting.

As set out in the Pool's July 2016 submission, for the time-being listed assets will continue to be held in segregated mandates as detailed analysis has demonstrated that due to the existing scale and relatively low costs of the participating funds it is not cost effective for the Northern Pool to establish and operate an Authorised Contractual Scheme. This will be regularly reviewed going forwards.

Further details of the plan for obtaining FCA authorisation for the Pool's GLIL infrastructure vehicle are provided under Criterion D: Infrastructure.

- **please identify risks or issues which may delay delivery by April 2018, and any plans to mitigate risks and/or manage issues .**

The Northern Pool is firmly on track to meet the pooling Criteria and Guidance as issued by DCLG In November 2015 by the April 2018 deadline.

Alongside and complementary to the Criteria issued by Government, the Northern Pool has agreed its own fundamental objectives which are:

- To maintain strong performance and low cost
- Simplicity
- Accountability
- Commitment to UK infrastructure investment, in particular the financing of new homes

One of the key challenges for the Northern Pool is to deliver all of these objectives whilst obtaining FCA authorisation at the appropriate level, as set out in letters issued by DCLG since the Criteria and Guidance was issued.

It is clear that there are several differences between the Northern Pool and the other LGPS pools. In particular;

- The Pool consists of 3 large funds with relatively simple and distinct management arrangements, which means that the scope for generating further economies of scale in respect of the management of listed assets is limited. There are however, significant economies of scale to be accessed in the management of alternative assets.
- On the basis of the legal advice received, the number of participants in the Pool is small enough to allow collective investments to be made in alternative assets via joint ventures, as each fund can be directly involved in the investment decision making process (this approach has worked well to date on the GLIL infrastructure partnership).
- The participating funds are aware of the risks of being deemed to be operating an unauthorised collective investment scheme and on the basis of the legal advice received and experience to date, are confident that this risk can be adequately managed via the investment management arrangements that will be in place from April 2018.

The vast majority of the benefits of pooling for the funds in the Northern Pool are in respect of alternative assets where there is greatest scope to generate further economies of scale and to combine resources to make increasingly direct investments. Following detailed discussions with each of the fund's advisors and the professional advisors to the pool, it has been agreed that in order to best meet the Reduced Costs and Excellent Value for Money criteria set by Government, the Northern Pool should focus resource on making collective investments in alternative assets (which will commence and start generating material cost savings from April 2018) rather than establishing an AIFM as a pool operator in the short term.

The Pool has been clear in discussions with DCLG that it will seek FCA authorisation at the appropriate level in order to maximise the benefits of pooling and meet the pooling Criteria and Guidance.

Each of the participating authorities are firmly of the view that the Scale and Strong Governance and Decision Making criteria will be met in full by appointing an FCA regulated common custodian for the Pool, which will have custody of all the pool's listed assets (i.e. internally and externally managed equities and bonds). Pooled vehicles for alternative assets will operate via joint-ventures, as per the current operation of the GLIL infrastructure vehicle, but are being designed in such a way that they can be converted to operate as FCA regulated entities as and when required.

It is clearly understood by each of the administering authorities that strategic asset allocation will be set by each fund's pension committee with the selection of individual investments and investment managers carried out by appropriately qualified and experienced individuals, operating under the legal framework of specialist investment vehicles where appropriate (i.e. GLIL, Northern Pool private equity).

This is in many respects little changed from how the funds currently operate, but will be formally documented in the Terms of Reference of the Pool Joint Committee, the participating funds' pension committees and of the individual investment vehicles established.

~~For operational pools~~

- ~~• Structure and scale – please state the total value of assets to be invested via the pool together with the value of assets to be invested outside of the pool by participating funds~~
- ~~• Progress with transition – please state the value of assets within the pool, and provide an updated high level transition plan~~

Criterion B: Governance

For pools in development

- **Progress with governance arrangements - please provide an updated high level project plan for the implementation of governance arrangements**

The Pool intends to take the quality and consistency of the scrutiny and reporting to a very high level

Governance milestones achieved to date include:

- Establishment of a shadow joint committee for the Pool which meets on a six-weekly basis, which will shortly convert to a formal joint committee.
- Agreement of trade union representation on the joint committee once formally established.
- Agreed approach for performance and cost reporting and benchmarking, which will be implemented prior to the formal establishment of the Pool.
- Alignment of approach between the 3 funds to exercising voting rights on listed equity assets.

The legal agreements setting out the governance framework of the Pool are not yet finalised as work is being undertaken to ensure that they are aligned with the governance framework of the private equity vehicle which is under development.

Please see Appendix 1 attached which sets out the further work to be undertaken up to April 2018.

For operational pools

- ~~Changes to governance since final proposal [and/or Spring 2017 progress report] – briefly describe any changes to the governance structure, in particular please set out your plans for ensuring the pool can effectively implement the asset allocation and responsible investment strategy of each fund~~

Criterion C: Reduced costs and value for money

For all pools

- **Update on costs estimates – please state current high level estimates for implementation costs to date, by go live and following go live.**

Implementation costs to date are approximately £200k.

Overall implementation costs are expected to be materially lower than those estimated in the July 2016 submission, which estimated costs of £1.8m. The majority of the implementation costs are expected to be incurred prior to the go live date.

- **Update on annual savings estimates, including reductions in fees/mandates**

We believe eventual savings will be higher than the £28.3m p.a. estimated in our July 2016 submission.

Since making the July submission the funds in the Pool have already achieved recurring cost savings of approximately £10m p.a. as a result of making direct infrastructure investments via the GLIL vehicle rather than 3rd party fund managers and by re-negotiating fees with external securities managers. We believe this is a particularly significant achievement given the already low costs of the funds in the Pool.

The Pool is using the CEM Benchmarking service to obtain a detailed comparison of costs and performance as at 31 March 2017 against relevant global comparators. This report is not yet available, but is expected soon and the Pool would be happy to share this with Government.

- **Plans for delivering savings – please set out your high level plan and timescales for delivering the annual savings above**

The savings arise predominantly from the increased resource of the Pool enabling some alternative asset classes to be accessed in a more cost effective way. Over the implementation period it is assumed that the Pool will:

- Move from private equity fund of funds to single funds/co-investments
- Move from hedge fund of funds to single strategy funds.
- Reduce the proportion of indirect property relative to direct property
- Reduce the proportion of indirect infrastructure relative to direct infrastructure

The phasing of the costs savings over the period up to 2033 reflects the anticipated expiry dates of existing illiquid investments and realistic expectations of when the Pool will have the necessary capacity and capability where required. Direct

infrastructure investments are already being made via the GLIL vehicle and collective private equity investments are expected to be made from 2018 onwards.

Additional cost savings are anticipated (but not included in the figures above) from moving the management of a proportion of the equities and bonds which are currently externally managed to in-house management over a period of time as appropriate internal capacity is developed.

- **Plans for reporting including on fees and net performance in each listed asset class against an index**

It is expected that the investment performance of LGPS Pools will come under intense scrutiny. In this context, the Northern Pool, and the individual funds within the Northern Pool have decided to appoint their own independent, third party provider of core performance measurement calculations operating to relevant industry standards. This service may be provided by the Pool Custodian, when appointed.

The Northern Pool and the funds within the Northern Pool will also procure:

- an added-value performance analytics service
- a common provider of universe collation, analysis and research services. And
- a common provider of cost analysis, benchmarking and value-add analysis services .
- **Plans for how the pool will report publicly on a fully transparent basis – please confirm that the pool will adopt the Scheme Advisory Board Code of Transparency for reporting to participating funds**

The Pool will publish, on at least an annual basis, its performance and cost data. This will also be published on the websites of the individual funds within the Pool.

The Pool will adopt the Scheme Advisory Board Code of Transparency in respect of its private market investment vehicles and will seek to ensure that all managers of listed assets also adopt Code of Transparency.

Criterion D: Infrastructure

For all pools

- **Progress on infrastructure investment – please state your target allocation for infrastructure and committed funds at the pool level and/or across pools. Please also set out your plans for the platform/product/and/or external manager arrangements to achieve that target**

As set out in its July 2016 submission, the Northern Pool has a target allocation to infrastructure of 10% of Pool assets (equivalent to £4.2bn at 31 March 2017), which will be delivered via the 'GLIL' direct infrastructure vehicle, allocations to infrastructure funds and extending the existing direct investment activities of the 3 funds in this area, for example GMPF's Matrix Homes which works in partnership with local authorities to finance the construction of new homes on sites that would not otherwise be developed.

As part of this commitment to infrastructure investment, the Pool has an objective of financing 10,000 new homes over the next 3 years.

Up to 30 September 2017, GMPF has financed 284 completed homes, with a further 1,738 under construction. Due diligence is currently being undertaken on 9 further projects which would deliver another 2,270 homes. Discussions are also underway to extend the Matrix Homes model via joint ventures with other funds in the Pool.

Committed infrastructure funds at 31 March 2017 are set out in the table opposite. Figures at 31 March 2015 are provided in brackets to illustrate the significant progress made by the pool in increasing infrastructure investment. Committed funds stand at over £2bn, with over £1bn already at work.

		GMPF	MPF	WYPF	Pool
Direct	Allocated 2017 (2015)	£1,050m (£250m)	£155m (£30m)	£270m (£0m)	£1,475m (£280m)
	Committed	£500m (£250m)	£155m (£30m)	£266m (£0m)	£921m (£280m)
	At Work	£101m (£90m)	£51m (£15m)	£55m (£0m)	£207m (£105m)
Funds	Allocated	£1,050m (£680m)	£368m (£320m)	£400m (£325m)	£1,818m (£1,325m)
	Committed	£654m (£469m)	£332m (£272m)	£378m (£366m)	£1,364m (£1,107m)
	At Work	£393m (£224m)	£241m (£220m)	£236m (£271m)	£870m (£716m)
Total	Allocated	£2,100m (£930m)	£523m (£345m)	£670m (£325m)	£3,293m (£1,600m)
	Committed	£1,154m (£719m)	£487m (£302m)	£644m (£366m)	£2,285m (£1,387m)
	At Work	£494m (£314m)	£292m (£235m)	£291m (£271m)	£1,077m (£820m)

GLIL

In December 2016 the original partners in GLIL Infrastructure welcomed their respective pooling partners into an expanded vehicle (referred to as GLIL 1.5). The new structure included each of the members of both Northern Pool and LPP and enjoyed increased capital commitments to £1.3bn. GLIL 1.5 has invested £280m in a combination of greenfield and brownfield UK direct infrastructure assets and is currently undertaking detailed due diligence/negotiation on a significant pipeline for investment. The current portfolio is generating income in excess of 5% per annum which is well ahead of schedule for a portfolio of this type.

GLIL has already developed a template for successful sourcing and delivery through an experienced team of investment compliance, operational, risk and programme management professionals. It is becoming widely recognised as an established investor in the UK and international Infrastructure sectors and is very much on the radar for receipt of investment opportunities.

Moreover, in its current format, GLIL operates with extremely low running costs; aggregate ongoing staffing and management costs are less than 25bps per annum versus a typical infrastructure annual management fee of c.125bps per annum (plus performance). All fee savings flow directly to investors.

Each of Northern Pool and LPP are active participants in the LGPS Infrastructure cross pool group and we continue to support colleagues through sharing of best practice and ideas. To this end we have initiated the process of further evolving GLIL in order to make it available to all LGPS Funds/Pools. In order to achieve this wide availability and maintain GLIL's track record for delivery it will be necessary to broaden the routes to accessing the investment opportunities. Critically GLIL 2.0 will enable Funds/Pools without the relevant scale and/or internal expertise to participate passively and without the need to be involved in day to day investment management.

The fact that not all investors will be participating in the day to day management of GLIL 2.0 means that it will become classified as an "alternative investment fund" (AIF) for the purposes of the Alternative Investment Fund Managers Directive (AIFMD) and the UK regulatory system.

It would be possible for GLIL to establish a new entity which applies directly to become a "self-managed" AIF. However, the existing investors have considered this option and concluded this would be a costly and time consuming process which is better avoided. By using an existing alternative investment fund manager (AIFM) GLIL is able to significantly shorten the time before new investors can join and save material costs and uncertainty which would be associated with a new application process.

To this end GLIL is in the process of updating its legal form and appointing an AIFM to provide regulatory hosting services under a commercial contract to ensure compliance with the AIFM directive. The existing members of GLIL 1.5, together with relevant new members (i.e. those making significant capital contributions and with the requisite human resource), shall nominate representatives to the GLIL 2.0 governance structures with those involved in the Investment Committee being registered as carrying out Controlled Functions under its regulatory licence.

This is an interim solution aiming to deliver an infrastructure platform for as many participants as possible whilst implementation of pooling takes its course. Other regulatory solutions will be examined and during this process the funds in the Northern Pool will hold the majority of assets in GLIL and play a crucial part in the management of the assets.

- **Timetable to achieve stated ambition - please provide a high level project plan for the implementation of the platform/product/and/or external manager arrangements described above**

This new structure described above is expected to be operational by February 2018 and will allow any LGPS fund, no matter of commitment size or resources, to access direct infrastructure assets in a low cost and effective manner alongside the existing members of GLIL. The management costs of GLIL are charged on a cost recovery basis which will ensure it will be a cost effective vehicle for all participants regardless of the extent of their involvement.