



Committee and Date  
Pension Committee  
25 November 2016

Item

9

Public

## LGPS CENTRAL - INVESTMENT POOLING

**Responsible Officer** James Walton

e-mail: [james.walton@shropshire.gov.uk](mailto:james.walton@shropshire.gov.uk)

Tel: (01743)  
258915

### 1. Summary

- 1.1 This report outlines the changes that will be required to the operational and governance arrangements for the Shropshire County Pension Fund following recent amendment of the Local Government Pension Scheme (LGPS) Investment Regulations.
- 1.2 The revised regulations require all LGPS administering authorities in England and Wales to enter into joint (pooled) arrangements with other LGPS pension funds for the management of their investment assets, with effect from 1<sup>st</sup> April 2018, in order to achieve scale economies and increase investment capacity.
- 1.3 The Shropshire County Pension Fund has been working with seven partner funds on a proposal which will meet the criteria for pooling laid down by the Secretary of State, by establishing a jointly owned investment management company, to be known as 'LGPS Central'.
- 1.4 The proposal to establish LGPS Central is supported by a comprehensive business case, approved at Pensions Committee on 28 June 2016. The business case has been reviewed by a joint Department for Communities and Local Government/Treasury (HMT) Review Panel, and Ministerial consent has been received. Each participating Pension Fund will be taking the recommendations set out in this report to their respective administering authority Full Council Meeting's in order to approve these recommendations and formally approve the pooling arrangements. Proceeding with the proposals set out in this report, therefore, is subject to the approval of all the participating Pension Funds, which will be sought at their respective Council meetings over the coming months.

### 2. Recommendations

**Pension Committee are asked to recommend that Council approve the following recommendations:-**

- 2.1 To enter into an Inter Authority Agreement with Cheshire West & Chester Council, Derbyshire County Council, Leicestershire County Council, Nottinghamshire County Council, Staffordshire County Council, Wolverhampton City Council and Worcestershire County Council to establish a joint pension fund investment pool, in accordance with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and pursuant to that Inter Authority Agreement set up; and operate a Joint Committee under s102 of the Local Government Act 1972 to oversee the joint investment arrangements.
- 2.2 To agree that Cheshire West and Chester shall provide governance and administrative support to the Joint Committee on behalf of the participating Council's, subject to the appropriate cost sharing arrangements in respect of officer time and other expenses.
- 2.3 To become a joint shareholder of LGPS Central; a private company, limited by shares, held solely by the participating funds named in recommendation 2.1, on a 'one fund, one vote' basis; incorporated for investment management purposes and regulated under the Financial Services and Markets Act 2000.
- 2.4 To authorise the Shropshire Council Member who holds either the position of Chair or Vice Chair of the Shropshire County Pension Fund, to appoint themselves or other Shropshire Council Members of the Pension Committee to undertake the following roles:
  - i) To act as the Council's representative on the Joint Committee;
  - ii) To exercise the Council's voting rights as a shareholder of LGPS Central, to be exercised in consultation with the Head of Finance Governance & Assurance (s151 Officer) where the vote is in respect of a Reserved Matter as set out in Schedule 1 of the Shareholders agreement;and each Member so appointed shall have delegated authority to undertake such roles.
- 2.5 To agree that the Shropshire Council Members appointed under recommendation 2.4 above shall be authorised to appoint a substitute, provided that substitute is a Shropshire Council Member of the Pensions Committee, and agree that, wherever possible, the Member (or their substitute) appointed to the Joint Committee shall not be the same Member as currently appointed to the Shareholder Forum, so as to avoid potential conflicts of interest.
- 2.6 To agree that the signatory on behalf of the Council as Shareholder shall be the Council's Head of Legal & Democratic Services.
- 2.7 To appoint the Head of Finance Governance & Assurance (s151 Officer) and Scheme Administrator of the Pension Fund or their nominated representative to represent the Council on a Practitioner

Advisory Forum, providing joint officer support to the Joint Committee and Shareholder Forum.

- 2.8 To approve the revised terms of reference for the Shropshire County Pension Fund Committee as set out in Appendix 3 to this report.
- 2.9 To delegate authority to the Head of Finance Governance & Assurance (s151 Officer) in consultation with the Shropshire Council Chair or Vice Chair of the Pension Committee to negotiate and agree all necessary legal agreements to establish a joint asset pool and investment management company as outlined in this report and to implement the recommendations and to authorise their execution.

## REPORT

### 3. Risk Assessment and Opportunities Appraisal

- 3.1 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.
- 3.2 There are no direct environmental, equalities or climate change consequences arising from this report.

### 4. Financial Implications

- 4.1 There is no direct impact on the Council's revenue or capital budgets as all costs (including regulatory capital) will be met from the Pension Fund.
- 4.2 The estimated cost of setting up the jointly owned company is £3.2 million, this will be shared equally between the participating funds, with Shropshire's share being around £400,000. There will also be significant transition costs as existing investment mandates are unwound and funds are transferred into new collective investment vehicles. It is not possible to accurately predict these costs, but the business case includes an estimate of £50million. Transition costs will be shared between the funds on an equitable basis.
- 4.3 In addition, as the new company will be a regulated entity, under Financial Conducts Authority (FCA) rules, it will need to hold regulatory capital to guarantee its solvency. The regulatory capital requirement is expected to be in the region of £10 million (£1.25 million per pension fund).
- 4.4 Estimated net total savings for the pool are in the region of £182 million over a period from 2018/19 to 2032/33, with annual savings of around £29 million being achieved by the end of this period. The comparative figures for the Shropshire County Pension Fund are £41.8 million and £3.5 million respectively.

### 5. Background

- 5.1 The LGPS is one of the largest funded pension schemes in the world with combined assets of around £200 billion. These are managed by

89 local administering authorities, who historically, have maintained separate arrangements of scheme assets, overseen by their respective Pension Fund Committees.

- 5.2 Between them it is estimated that administering authorities incur total administrative and management costs of around £500 million per year, a significant proportion of which relates to investment management fees paid to external fund managers. Funds often use the same managers, offering the same or similar services but appointed under separate agreements and on different fee terms.
- 5.3 Funds also vary significantly in scale; large funds enjoy direct access to a wide range of investment markets and products and can often negotiate more competitive fees, whilst smaller funds have more restricted options due to lower levels of investible resources, and expertise and have less negotiating power in the market.
- 5.4 Over the past two and half years the government has explored a number of options for improving the efficiency and sustainability of the scheme, and has undertaken extensive consultation on the potential to deliver savings through greater collaboration. A national cost benefit exercise, led by Hymans Robertson concluded that significant savings could be achieved through greater use of collective investment approaches, provided that certain regulatory restrictions were removed.
- 5.5 Subsequently, the government announced its intention to introduce a new regulatory framework which would facilitate collective investing and issued guidance and criteria to help administering authorities to develop proposals for pooling aimed at reducing costs and improving efficiency. Initial proposals were required by February 2016, followed by more detailed business case submissions in July 2016, with a target implementation date of 1st April 2018. The government also announced that 'backstop' powers would be introduced to allow the Secretary of State to intervene where authorities failed to bring forward sufficiently ambitious proposals in accordance with the guidance and criteria issued.
- 5.6 The reasons for the recommendations are to allow the Council to comply with updated LGPS Investment Regulations which came into effect in November 2016, requiring all administering authorities to commit to an investment pooling arrangement which meets the criteria and guidance laid down by the Secretary of State in November 2015.
- 5.7 Where authorities fail to comply with the criteria and guidance, the Secretary of State has powers to intervene, and to issue a Direction requiring changes to investment strategies and investment management arrangements, or the transfer of the investment functions of an administering authority, either to himself or a nominated party.
- 5.8 The proposal to establish LGPS Central is supported by a comprehensive business case, which demonstrates the potential for

significant savings in investment costs and management fees over the longer term, without detriment to investment performance and local accountability.

## 6. LGPS Central

- 6.1 Prior to the government's announcement, the Shropshire County Pension Fund has already established close working links with a number of other funds in, and around, the Midlands area and had begun to explore the scope for wider collaboration, starting with a successful joint procurement exercise in 2015, which resulted in a substantial fee saving on the funds' passively managed equity portfolio. The fee reduction achieved was in the region of 50%; in cash terms around £100k per annum for the Shropshire Fund.
- 6.2 These informal links become the starting point for wide discussions in the context of the formal requirement for pooling, resulting in a joint proposal from Cheshire, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands and Worcestershire to create 'LGPS Central', with combined assets of £35 billion.
- 6.3 Following confirmation from the Minister that this proposal was acceptable, a joint working group of officers, supported by external advisors, developed a detailed business case setting out how LGPS Central will meet the four key assessment criteria laid down by the government :-
- Criteria 1 – Asset pool(s) that achieve the benefits of scale (£25 billion plus)
- Criteria 2 – Strong governance and decision making
- Criteria 3 – Reduced costs and value for money
- Criteria 4 – Improved capacity and capability to invest in Infrastructure
- 6.4 Detailed reports have been presented to the Shropshire County Pension Fund Committee, explaining the key elements of the business case and seeking their approval for the proposed governance, oversight and management structure of the pool, which is summarised in Appendix 1.
- 6.5 The structure will allow participating funds to exercise control (both individually, and collectively) over the new arrangements, not only as investors in the pooled fund, but also as shareholders of the operator company, LGPS Central.
- 6.6 Whilst assets will be managed on a pooled basis, each fund will be able to exercise their investor rights independently, although clearly, benefits of scale will most effectively be harnessed where parties work together, in a co-ordinated way to align their decision making. An important example being social, environmental and governance policies and policies on the exercise of voting rights, where cross-

voting between funds within the same pool would be both costly to administer and counter-productive.

- 6.7 The Joint Committee will be the forum for dealing with common investor issues, and for collective monitoring of the performance of the pool against the objectives set out in the LGPS Central business case submission. The Joint Committee will however, have no formal decision making powers and recommendations will require the approval of individual authorities, in accordance with their local constitutional arrangements. An overview of the draft Inter Authority Agreement setting out the relationship between the participating pension Funds and the operation of the Joint Committee is set out in Appendix 2.
- 6.8 The Shareholder Forum, operating under company law, will have formal decision making powers. The Shropshire County Pension Fund will have equal voting rights alongside the other participating funds, and unanimous decisions will be required on key strategic matters, which will be specified in the company Shareholders Agreement and Articles of Association. This will include the appointment and dismissal of the company's senior executives, approval of the company's strategic plan and any significant financial transactions, such as major acquisitions and lending or borrowing. An overview of the Shareholder Agreement and key principles of the Articles of Association is set out in Appendix 2.
- 6.9 The degree of control to be exercised by the Shareholders through their reserve powers will be greater than is generally the case, in order to satisfy the Teckal exemption criteria (as now set out in Regulation 12 of the Public Contracts Regulations 2015) and allow the company to undertake services on behalf of the investor funds without a formal procurement process.
- 6.10 In order to avoid potential conflicts of interest and to maintain clarity over the governance arrangements, it is recommended that the Council nominates different representatives to the Joint Committee and the Shareholder Forum.
- 6.11 The government has also made clear their expectation that pooled entities must be registered with the Financial Conduct Authority (FCA) and regulated under the Financial Services and Markets Act 2000, to ensure appropriate safeguards over the management of client monies. As such, the new LGPS Central company will be subject to on-going oversight by the regulator and key management positions, including the company directors will need to be 'approved persons', able to demonstrate appropriate knowledge, expertise and track record in investment management. They will also carry significant legal, personal liability for their actions and decisions.
- 6.12 The relative merits of buying, or renting an established operator to manage the day to day running of the pool, have been carefully considered against the benefits of setting up a jointly owned company, with associated shareholder rights. The constituent funds

unanimously agreed that the latter option, whilst more expensive, offers significant advantages in terms of great flexibility and control, and this is the basis upon which the business case has been developed.

- 6.13 Staff who are currently employed by the partner Funds to manage their investments will transfer under the Transfer of Undertakings (Protection of Employment) regulations (TUPE) to the new company. As the Shropshire County Pension Fund does not currently have an in-house investment team, no staff transfer implications are anticipated for the Council, although the ability to access internal investment resources through the pool offers potential for additional future savings.
- 6.14 The detailed business case has been reviewed by a joint DCLG/HMT Review Panel, and Ministerial consent to proceed has been received.

## **7. Impact on the role of the Shropshire Pension Fund Committee**

- 7.1 The current terms of reference for the Shropshire County Pension Fund are attached in Appendix 2, along with suggested amendments to reflect their post-pooling responsibilities.
- 7.2 For the most part, the role of the Committee will be unaffected by the implementation of pooling and the creation of LGPS Central. The Committee will continue to be responsible for monitoring the overall management, performance and administration of the fund, and for setting investment strategy, including the overall allocation of assets, which is the critical factor in determining investment performance.
- 7.3 Importantly, they will also continue to be responsible for communicating with individual scheme members, whose benefits are guaranteed in law, and are therefore not affected by the new pooling arrangements or investment performance.
- 7.4 Responsibility for appointing investment managers and overseeing their performance, including any decision to dismiss, will however transfer to the Company, as will tactical decisions on the implementation of the overall investment strategy and the choice of specific investment vehicles.

## **8. Legal Aspects**

- 8.1 Shropshire as an administering authority, will enter in to the joint agreements forming LGPS Central, establishing a Joint Committee, representation on the relevant bodies described and modifying the terms of reference of the Shropshire Pension Fund Committee, in reliance on the exclusive rights given to local authorities to undertake administrative arrangements of this nature in sections 101, 102, 112 and 113 of the Local Government Act 1972 and the regulations made under these Acts; together with the general power within section 2 of

the Localism Act 2011 and the supporting provisions within section 111 of the Local Government Act 1972.

- 8.2 These powers are exercised as a response to the Chancellor's requirement in 2015 to pool pension assets to seek savings in management and administrative costs. The proposals are subject to approval by the Secretary of State. Whilst the government has not yet imposed a statutory mechanism for implementing pooled funds, there is a provision included in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 that came into force on 1 November 2016 whereby the Secretary of State can require those administering authorities who do not come forward with sufficiently ambitious proposals to pool their assets with others. Shropshire has determined to be proactive in its arrangements and develop the model of pooled funds as described in this report via devolved powers.

## **9. Risks and how Reduced**

- 9.1 The key risks are:-
- failure to achieve the statutory implementation deadline of 1<sup>st</sup> April 2018
  - failure to manage costs and savings in line with the agreed business case
  - failure to meet the requirements of the FCA regulator
  - failure to recruit appropriately skilled and experienced senior personnel to the new company
- 9.2 Comprehensive programme governance arrangements are in place to ensure that the statutory deadline for the implementation of pooling is achieved and that costs and savings are managed in accordance with the agreed business case. The s151 officers of each of the participating funds sit on the LGPS Central Programme Board and regular joint meetings are held between the Chairs and Vice-Chairs of the respective Pension Fund Committees to ensure effective member oversight of progress and delivery. The Shropshire County Pension Fund Committee and Local Pensions Board are also being updated regularly on key developments and decisions, as are the fund employers.
- 9.3 Expert advisers have been appointed to provide support on legal matters, FCA registration, taxation and overall programme management, and professional recruitment consultants are being appointed to assist and advise on executive recruitment and remuneration.

## **10. Alternative options**

- 10.1 The options of renting or buying an operator to manage the pool (rather than setting up a wholly owned company), have been considered and rejected due to market risk (limited supplier choice), and on governance grounds. The option of setting up a non-incorporated shared service arrangement has also been rejected due



to significant regulatory risk. It is planned that monthly briefing notes will be circulated to Pension Committee members in order to keep them informed of the progress in setting up the LGPS Central investment pool. The first one was produced in May 2016.

**List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)**

Pensions Committee, 28 June 2016, LGPS Central Investment Pooling  
Shareholders Agreement  
Inter Authority Agreement  
Articles of Association

**Cabinet Member**

Malcolm Pate, Leader

**Local Member**

N/A

**Appendices**

- 1 – Eversheds governance structure paper
- 2 – Overview of governance documents
- 3 – Pension Committee Terms of Reference