



**LOCAL GOVERNMENT
PENSION SCHEME**
Statutory Guidance on Asset Pooling

Consultation Response from LGPS Central Limited

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INTRODUCTION

Background

LGPS Central Limited is one of eight Pool companies formed in response to HM Government's call in 2015 for LGPS funds across England and Wales to pool their investment assets with the aims of:

1. Reducing investment management costs through economies of scale.
2. Improving access to alternative asset classes.
3. Strengthening governance and decision-making across the scheme.

LGPS Central Limited was established to manage the pooled investment assets of nine Local Government Pension Schemes (LGPS) across the centre of England: Cheshire, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands, the West Midlands Integrated Transport Authority (ITA) and Worcestershire, together our "Partner Funds". The company launched on 1st April 2018 and is being built so that it will ultimately have the capability to manage over £45 billion of assets on behalf of almost one million LGPS members and some 2,000 participating employers.

LGPS Central Limited is jointly-owned by its Partner Funds¹ and is authorised and regulated by the Financial Conduct Authority (the FCA).

Our Shared Objectives

LGPS Central Limited and our Partner Funds have committed to the following eight Shared objectives. These form part of the Pool's founding documents (the Inter Authority Agreement and

1. To meet the investment objectives of the participating LGPS funds.
2. To establish a collaborative platform through which administering authorities of the participating LGPS funds can aggregate their pension assets with a view to providing scale economies and improved investment efficiency.
3. To develop internal investment management capabilities for the collective benefit of the participating LGPS funds, to provide wider investment choice and market competition.
4. To create capacity to invest in asset classes which individual funds may find difficult to access.
5. To stimulate innovation and provide an opportunity for funds to engage with the investment industry in finding new and creative approaches to the funding challenges faced by the LGPS (and the wider pensions sector).
6. To act as a responsible, long-term investor, using its influence as a shareholder to promote the highest standards of corporate stewardship.
7. To create a regional centre of excellence for investment management, able (in the long term) to offer services to other pension funds, charities and endowments.
8. Following transitioning arrangements, to invest each Shareholder's pension assets either through the ACS operated by LGPS Central Limited, as the primary and exclusive collective investment vehicle for all eligible pension assets, or by appointing LGPS Central Limited to manage any non-eligible assets outside of such ACS.

¹ The West Midlands ITA does not have an ownership interest in LGPS Central Limited

Shareholders' Agreement) and remain the cornerstone aims and principles for the operation of the business and our relationships with Partner Funds.

OVERALL VIEW OF LGPS ASSET POOLING

LGPS Central Limited is encouraged that the Government has recognised the considerable progress made in the establishment of eight pools and their initial operational successes.

Much has been achieved, but there is still much more to be done and we support the Government's continuing use of Statutory Guidance to maintain the momentum of the pooling process.

We welcome the clear steer provided in the latest draft Guidance that administering authorities should seek to pool all their assets through FCA authorised Pool companies such as LGPS Central Limited. But we also recognise the implicit obligation this places upon us to develop the capabilities and provide the Pool vehicles to facilitate this and to maintain the administering authorities' target levels of investment returns. Our 2019/20 strategic business plan, recently approved by all LGPS Central Limited Pool members, has been explicitly designed to meet this objective.

Everyone at LGPS Central Limited is committed to working in partnership with our Pool members and strongly believes that successful asset pooling will only be achieved by working collaboratively throughout the process.

We believe that moving at pace towards all LGPS being assets managed either by or through Pool companies such as LGPS Central Limited, is the way to secure the maximum benefits of scale, improved asset class access and strengthened governance for all LGPS members and their dependents.

LGPS CENTRAL RESPONSE TO SPECIFIC GUIDANCE

Individual comments are made below relating to specific points contained within the statutory guidance. These are generally made with reference to the common shared objectives of LGPS Central Limited and our Pool members.

LGPS Central Limited agrees with those guidance points where no specific comments are made.

3. Structure and Scale

Shared objective 1: **“To meet the investment objectives of the participating LGPS funds”**

Shared objective 3: **“To develop internal investment management capabilities for the collective benefit of the participating LGPS funds, to provide wider investment choice and market competition.”**

Shared objective 4: **“To create capacity to invest in asset classes which individual funds may find difficult to access.”**

LGPS Central Limited strongly supports the guidance that Pool companies should be regulated by the Financial Conduct Authority. We believe that Pool companies responsible for billions of pounds of Pool member pension scheme assets should be subject to the same disciplines, resource requirements and investor protections as the broader UK investment management industry (3.4). Consistent regulation, and therefore regulatory capital requirements, across all Pool companies will also enable valid performance and cost comparisons to be made.

We believe that once appropriate capabilities have been established, in-house management at a Pool company will be able to deliver comparable gross risk adjusted investment returns more cost effectively than external management arrangements. We believe it is imperative there is full cost transparency to enable valid return comparisons, both gross and net, to be made and to support this contention (3.2).

As a Pool company we are committed to working with our Pool members to develop the internal capabilities necessary to manage an increasing proportion of Pooled assets. We recognise that building in-house management skills takes time and needs to be focussed initially on the asset classes where the most value can be added for Pool members. We believe this philosophy is equally applicable to Private markets such as infrastructure, private equity and real estate, and to public market asset classes such as fixed income and equities and to both active and passive management strategies.

In the interim we will seek to partner with external managers to ensure availability of the range of Pool vehicles that Pool Members need to implement their full strategic asset allocations and to deliver the best possible risk adjusted returns and governance.

LGPS Central Limited and our Pool members have a shared investment belief that active management can improve returns and add value. The additional costs of active management are always considered when assessing realised performance (3.6). Where there is a shared belief that no opportunity exists to gain excess returns through active management, we will seek to work with Pool members to implement passive/index alternatives. However, it is important to recognise that

passive/index products are not “risk free” on an absolute return basis, and market-cap based indices do not always offer the best risk adjusted returns after costs.

LGPS Central Limited believes that Pool companies will be able to contribute resources and expertise to the proposed regular reviews of active and passive management. We would envisage these reviews being performed in collaboration with Pool members, likely through a specific working group.

4. Governance

Shared objective 1: **“To meet the investment objectives of the participating LGPS funds”**

Establishing new, regulated Pool companies inevitably incurs a short-term cost. The benefits of lower fees, better governance and improved asset class access will increase over time as the scale of assets managed by Pool companies increase.

LGPS Central Limited recognises the need for governance bodies to carefully consider the financial costs/benefits at a local level and the balance that needs to be struck between long-term gains and short-term costs. We believe it is important for Pool companies to be demonstrating clear progress towards the point of cost break even, as a key input to this consideration (4.4).

For the Pool members of LGPS Central Limited it is investment performance net of all costs and fees which supports their continuing ability to pay pensions when they fall due. As a Pool company we are committed to selecting the fund managers, be they external managers or internal Pool company teams, who are most likely to consistently deliver target risk-adjusted investment performance over the long-term and not just those who offer the lowest management fees.

5. Transition of assets to the pool

Shared objective 8: **“Following transitioning arrangements, to invest each Shareholder’s pension assets either through the ACS operated by LGPS Central Limited, as the primary and exclusive collective investment vehicle for all eligible pension assets, or by appointing LGPS Central Limited to manage any non-eligible assets outside of such ACS.”**

In line with our shared objective, LGPS Central Limited supports the guidance that existing assets should transition into the pool as quickly and cost effectively as possible (5.1).

We recognise that Pool members may own assets where the cost of transition to a Pool vehicle may exceed the benefits of doing so, and therefore can be retained by the Pool member. We would welcome clarification that this exemption from pooling only applies to those assets which have a definitive maturity date, and therefore where accurate cost comparison calculations can be performed (5.4). A natural corollary of this is that where ongoing savings are demonstrably achievable, there is a presumption that transition to a Pool vehicle should proceed.

Where existing long-term investment contracts do not have fixed maturity dates, LGPS Central Limited is supportive of the “significant” cost penalty definition in deciding whether it is appropriate

for Pool members to retain management (5.5). Where Pool company capabilities exist and costs are similar, or lower, as above we would suggest a presumption that transition to a Pool vehicle should proceed.

Where Pool members do choose to retain assets outside of Pool vehicles, we support the Government's belief that "in many cases there will be benefits in retained assets being managed by the Pool company". We would suggest inclusion of a presumption that retained assets should be managed by the Pool company via segregated mandates to minimise fees and to prevent potential duplication of work.

We support the suggested regular review of retained assets (5.6). Consideration could be given to expanding the review criteria to "every three years or whenever the Pool company makes available a similar Pool vehicle with comparable or lower costs, risks and gross returns".

LGPS Central Limited believes that life funds should not be singled out as different from any other existing assets and therefore should be treated in the same way. As life fund assets are generally passively managed, they are amongst the most suitable to transition to Pool vehicles where the Pool company has established and operational passive management capabilities.

6. Making new investments outside the pool

LGPS Central Limited would like clarification on whether the Government is seeking to promote explicit competition between Pool companies (6.3)?

Shared objective 8: "Following transitioning arrangements, to invest each Shareholder's pension assets either through the ACS operated by LGPS Central Limited, as the primary and exclusive collective investment vehicle for all eligible pension assets, or by appointing LGPS Central Limited to manage any non-eligible assets outside of such ACS."

We support the guidance that each separate Pool member should normally make all new investments through the Pool company in order to maximise the benefits of scale accruing to all Pool members (6.1). But equally we recognise the importance of working with each Pool member to ensure the availability of Pool vehicles which meet their full strategic asset allocation needs. As a Pool company, LGPS Central is committed to developing the capabilities required to offer a broad range of Pool vehicles within the agreed 2020 timetable. The precise fund offerings will be driven by Pool member preferences and the specific characteristics of each asset class. They are therefore likely to be a mix of active/passive and internally/externally managed.

If it is "essential" for Pool members to make new investments outside of their pool (6.4) to deliver their investment strategy, consideration should be given to including in the guidance the presumption that assets should transition back to the pool once comparable Pool vehicles become available.

DISCLAIMER



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