

LGPS POOLING OF INVESTMENTS

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Board before taking effect.

Recommendation: that the Board notes the report.

1. Introduction

- 1.1. The Government announced in the July 2015 budget statement that they intended to work with Local Government Pension Scheme (LGPS) administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance.
- 1.2. In response to this announcement the Investment and Pension Fund Committee resolved at its meeting in September:
 - (a) that approval in principle be given to the establishment of a South West Collective Investment Vehicle;
 - (b) that the County Treasurer be authorised to continue work with neighbouring funds in the South West to establish proposals for a South West Collective Investment Vehicle;
 - (c) that the Committee remain open to considering alternative pooling options in order to fulfil their obligation to provide best value for fund Members.
- 1.3. On 25th November, in conjunction with the Chancellor's Autumn Statement, the Government's criteria for investment pooling were issued, together with a timetable for LGPS administering authorities to respond.

2. Government Timetable and Criteria

- 2.1. Authorities were asked to submit initial proposals to the Government by 19th February 2016. The initial submission should include a commitment to pooling and a description of their progress towards formalising their arrangements with other authorities. Authorities could choose whether to make individual or joint submissions, or both, at this first stage.
- 2.2. Refined and completed submissions are expected by 15th July 2016, which fully address the criteria set out by the Government, and provide any further information that would be helpful in evaluating the proposals. At this second stage, the submissions should comprise:
 - For each pool, a joint proposal from participating authorities setting out the pooling arrangement in detail. For example, this may cover the governance structures, decision-making processes and implementation timetable; and
 - For each authority, an individual return detailing the authority's commitment to, and expectations of, the pool. This should include their profile of costs and savings, the transition profile for their assets, and the rationale for any assets they intend to hold outside of the pool in the long term.

2.3. The four criteria are set out in the following paragraphs.

Scale of Assets under Management

2.4. The Government's intention is that the 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25 billion of Scheme assets. Informal discussions have suggested that if a pool is nearer to £25 billion than £20 billion, then it is likely to be acceptable. The proposal will need to explain:

- The size of pool once fully operational, and its legal type.
- Assets outside of pool and rationale.
- Internal work and services to be hired.
- Timetable for establishment and asset transition.

Strong Governance and Decision Making

2.5. The governance structure should provide authorities with assurance that their investments are being managed appropriately by the pool, and ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted. Proposals will need to demonstrate:

- Accountability between pool and elected members, external scrutiny.
- Mechanisms for Authorities to hold pool to account.
- The process for decision making at all stages of investment.
- Resourcing.
- Net performance publication, benchmark usage.

Substantial Cost Savings

The proposal will need to outline the savings that can be achieved by the pool, including:

- An estimate of investment costs for the year to 31st March 2013 and the current level of investment costs.
- Detail on cost savings over 15 years.
- Estimate of implementation and transition costs.
- Proposals for reporting against forecasts.

Improved Infrastructure Capability

2.6. Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class. Authorities should explain:

- The existing proportion of Fund allocated to infrastructure.
- Proposals to acquire capacity and capability to assess infrastructure projects with reduced costs via pooling.
- Future proportion of Fund to be allocated and how derived.

3. Brunel Collective Asset Pool

- 3.1. Work has progressed on the proposal to set up a pool based on the South West, under the name of “Project Brunel”. This was initially supported by the eight South West funds - Devon, Cornwall, Somerset, Dorset, Wiltshire, Gloucestershire, Avon (managed by Bath and North East Somerset Council) and the Environment Agency (who are based in Bristol). Since November, Buckinghamshire and Oxfordshire have also joined the Brunel pool. The addition of these funds has increased the total assets of the member funds to approximately £23 billion.
- 3.2. The South West LGPS pension funds have a good record of working together. Officer meetings are held on a regular basis to share best practice, and a number of South West LGPS collaborative frameworks have been set up, for example in relation to actuarial and consultancy services and legal services. The funds are a good fit in terms of community of interest and shared objectives and the region shares many characteristics, such as demography, and would not be dominated by a large metropolitan authority. Buckinghamshire and Oxfordshire are of a similar size, and align well with the eight South West funds.
- 3.3. Appendices 1 and 2 to this report are the covering letter and proposal that were submitted to Government by their initial deadline of 19 February.
- 3.4. The recommendation in our submission is that a Collective Asset Pool (CAP) is our preferred option. The CAP joint committee approach should be easier and quicker to set up than an Authorised Contractual Scheme (ACS), would increase accountability and would be a lower cost overhead compared to an ACS. This approach was informally endorsed at a meeting of the Chairs of the committees of the participating funds at a meeting held in January and then formally endorsed by Committees in February.
- 3.5. Government feedback has encouraged the Brunel pool to review the joint committee approach, expressing the view that a structure regulated by the Financial Conduct Authority would provide significant assurance to local employers, beneficiaries and co-investors. As a minimum they expect to see a single entity at the heart of any proposal, with responsibility for selecting and contracting with investment managers, as well as the employment of staff. Work is now being undertaken by the Brunel pool to align the preferred structure with the Government’s expectations.

4. Other Pools

- 4.1. While work within the South West funds has been progressing, officers have also been monitoring other pooling initiatives. There are eight different pooling initiatives being put together across England and Wales. These are:
 - London
 - Lancashire/London Pension Fund Authority (LPFA)
 - Access (Central, East and South)
 - Project Brunel (South West plus Oxfordshire and Buckinghamshire)
 - Midlands
 - Borders to Coast (Surrey/Cumbria/East Riding/Warwickshire/ Lincolnshire)
 - North (Greater Manchester/Merseyside/West Yorkshire)
 - Wales

A map illustrating the latest information on membership of the different pools is attached at Appendix 3.

5. Conclusion

- 5.1. The Government's expectation is that each LGPS Fund should commit to a pool, and every fund has now stated which pool they propose to join. The Investment and Pension Fund Committee has committed in principle to pool its assets with the other founder funds of the Brunel CAP and has endorsed the project proposal at appendix 2 as a joint submission from Project Brunel, including the Devon Pension Fund.
- 5.2. The second stage of our proposal will be discussed at the training day scheduled for 27th May 2016, before being finalised at the June meeting of the Investment and Pension Fund Committee.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
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Local Government Pension Scheme: Investment Reform Initial proposal to the Department for Communities and Local Government

The Brunel Collective Asset Pool

In your 25 November 2015 document “Local Government Pension Scheme: Investment Reform Criteria and Guidance” you asked for initial proposals to Government from Authorities for pooling investments by the 19 February 2016.

Our initial proposal is a joint submission from Avon, Buckinghamshire, Cornwall, Devon, Dorset, the Environment Agency, Gloucestershire, Oxfordshire, Somerset and Wiltshire to establish a Collective Asset Pool overseen by a Joint Committee. This will deliver a permanent structure, centralising the key investment decisions in a professional operating group, driven by our officers and committed to the highest standards of governance.

In your Criteria and Guidance paper, you stated that proposals will be evaluated against four defined criteria, relating to scale, governance, cost reduction and the capacity to invest in infrastructure. Our initial proposal is structured under these four headings and provides our initial thinking on how the Brunel Collective Asset Pool (“the Brunel CAP”) will meet each criterion. We also append two reports from PricewaterhouseCoopers, supported by Squire Patton Boggs, which have informed our approach.

We look forward to engaging openly and actively with you over the coming months as we work towards completing proposals by 15 July 2016. Early resolution of any matters you wish to raise would enable us to launch the Brunel Collective Asset Pool by April 2017.

Authorised by the Chairs of Pension Committees for:

Avon	Councillor David Veale	Signature: 
Buckinghamshire	Councillor John Chilver	Signature: 
Cornwall	Councillor Derek Holley	Signature: 
Devon	Councillor Rufus Gilbert	Signature: 
Dorset	Councillor John Beesley	Signature: 
Environment Agency	Mr Clive Elphick	Signature: 
Gloucestershire	Councillor Ray Theodoulou	Signature: 
Oxfordshire	Councillor Stewart Lilly	Signature: 
Somerset	Councillor Graham Noel	Signature: 
Wiltshire	Councillor Tony Deane	Signature: 

18 February 2016

Project Brunel: Initial proposal to DCLG on investment pooling

A.	Asset pool(s) that achieve the benefits of scale	Initial proposal, subject to development in the July proposal
A1	<p>Anticipated size of the pool</p> <p>Throughout this proposal, we describe the pool proposed by Project Brunel as a Collective Asset Pool overseen by a Joint Committee, or the “Brunel CAP”</p>	<p>Project Brunel aims to achieve the £25 billion scale quickly. At least ten Founder Funds are envisaged: Avon, Buckinghamshire, Cornwall, Devon, Dorset, the Environment Agency, Gloucestershire, Oxfordshire, Somerset and Wiltshire. These Funds had total assets under management of £23 billion at March 2015.</p> <p>For operational efficiency, there would be a maximum of 12 Founder Funds. The pool could, therefore, work with two more like-minded Funds. There is a strong preference for a clear list of Funds at an early stage so that all can input on an equal basis into the detailed July proposal.</p>
A2	Assets proposed to be held outside the pool	<p>Founder Funds are looking to include all assets within the Brunel CAP, but are open to accessing investment opportunities e.g. infrastructure, passive equities using a national initiative.</p> <p>Founder Funds manage some assets internally. These total c£1.0 billion. These will be managed within the pool, with the mechanism for achieving this being confirmed in the July proposal.</p>
A3	Type of pool including legal structure	<p>The structure will be a Collective Asset Pool (“CAP”) overseen by a Joint Committee, to be established under existing legislation. This allows Founder Funds to retain both legal and beneficial ownership of pooled assets. It may be necessary to amend regulations to confirm that the Environment Agency has clear legal authority to delegate investment powers into a Joint Committee. The active support of the relevant Departments is sought for this.</p> <p>The Administering Authorities will delegate most of their investment powers to the Brunel Collective Asset Pool (the “Brunel CAP”), retaining strategic asset allocation decisions in respect of pooled assets. These decisions will be implemented by allocation between approximately 20 Sub-Funds offered by the Brunel CAP. This will allow a wide but clear choice, thus meeting the democratic accountability and strategic asset allocation criteria in the DCLG’s 25 November guidance paper, paragraphs 3.25 and 3.28.</p> <p>Crucially, each Sub-Fund will offer access to a given market or style of investment, with decisions between investment managers held within each Sub-Fund made at the Brunel CAP level. Participating Authorities will not have discretion between investment managers within a Sub-Fund: there may be more than one investment mandate within any given Sub-Fund, but all Participating LGPS Funds will hold mandates in equal ratios within that Sub-Fund. For further information see Sections 3.2 and 3.5 of the PwC Feasibility Report and Section 3 and Appendix 1 of the PwC February Report.</p>

Project Brunel: Initial proposal to DCLG on investment pooling

		<p>The Administering Authorities of the Brunel CAP intend to enter into a long term contractual agreement between them. Permanence will be delivered by clauses relating to the pricing of Sub-Funds (in effect unitisation pricing) and withdrawal notice period and terms. These contractual terms will recognise the permanence of the new overall UK pooling structures,</p> <p>The Brunel CAP will monitor other delivery models to ensure that all pooling is conducted in the most advantageous way.</p>
A4	<p>How the pool will operate, the work to be carried out internally and services to be hired from outside.</p>	<p>Initial thinking on Brunel CAP operation is described in Section 3 of the PwC February Report. See the schematic in section 3.2.7.</p> <p>There will be an Operations Group to carry out much of the work internally. Existing investment teams in the Founder Funds will work together to operate the Brunel CAP, making and managing appointments of Investment Managers within the Sub-Funds.</p> <p>Specialisation will be achieved through the use of five Portfolio Construction Groups. Transfers of employment between Founder Funds are not expected.</p> <p>A custodian will be hired to provide unitisation services. Administration, depositary, audit, tax and legal services will also be hired from outside. Other advisory services may also be required by the Brunel CAP and existing Framework Agreements will be used when applicable.</p> <p>Investment managers will engage with the Participating Funds using clusters of substantially identical Investment Manager Agreements.</p>
A5	<p>Timetable for establishing the Brunel CAP and moving assets into the pool. How progress will be reported transparently against that timetable.</p>	<p>The CAP structure can be established within 6-9 months of obtaining approval from DCLG, so Project Brunel proposes a commencement date for the Brunel CAP of April 2017. Asset transition planning will start before this, not least to avoid decisions in 2016 / early 2017 at a Founder Fund level that would complicate the pooling process.</p> <p>A two year period for transferring listed assets is expected, subject to analysis on transaction costs for mandate rationalisation. Efficient transfer of unlisted assets, including those with contractual tie-ins, may reasonably be completed within 10 to 15 years. More detail, including reporting proposals, will be provided in July.</p>

Project Brunel: Initial proposal to DCLG on investment pooling

B. Strong governance and decision making		Initial proposal, subject to development in the July proposal
B1	Assurance to individual Funds that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members.	<p>As indicated in the diagram for the CAP structure in section 3.2.7 of the PwC February Report, the Oversight Group will oversee reporting processes back to the Founder Funds' Pension Committees.</p> <p>Further detail on governance and reporting is being developed, and will be covered in the July proposal.</p>
B2	At the pool level, adequate assessment and management of risk, a long term view for investment implementation decisions and a culture of continuous improvement is adopted.	<p>The Brunel Pool expects to make appropriate use of external advisors and data aggregation techniques at the Oversight Group and Portfolio Construction Group level.</p> <p>Founder Funds are mindful that, just as their existing processes do not require oversight by the Financial Conduct Authority, neither does the CAP structure. Nonetheless, during development of the July proposal, the FCA processes for risk and process control will be reviewed so that the Brunel Pool can operate at the highest level of risk assessment and management, take a long term perspective for investment decisions and establish a culture of continuous improvement. These matters will be covered fully in the July proposal.</p>
B3	Governance structure for the Brunel CAP, including the accountability between the pool and elected councillors, and use of external scrutiny.	<p>There will be an Oversight Group with a scrutiny, challenge and ratification of process role. Chairs of Pension Committees, as elected councillors, will normally sit on this Group, on the basis of one seat for each Founder Fund. With no more than 12 Founder Funds, the Group will be a practical working size.</p> <p>There is no legal requirement for political balance or member representation on the Oversight Group, but these issues will be considered further, as will the position of the Environment Agency.</p> <p>The Oversight Group will include a Chair, independent of any of the Founder Funds, appointed from outside, to bring direct investment experience.</p> <p>These arrangements, including external scrutiny, will be considered further in the July proposal.</p>
B4	Mechanisms by which the authorities can hold the Brunel CAP to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.	<p>The Oversight Group will provide the primary formal mechanism by which Pension Committees can hold the Brunel CAP to account.</p> <p>The Operational Group will be responsible for providing information to Pension Committees of a quality sufficient to deliver assurance that investment are well managed and that strategy is being implemented effectively. This will include information on the Sub-Funds sufficient to enable Pension Committees and their advisors to make asset allocation decisions that fully allow for liability, deficit and contribution stability</p>

Project Brunel: Initial proposal to DCLG on investment pooling

		considerations. Founder Funds are expected to retain investment advisors but typically with revised roles, focussing on these matters.
B5	Decision making procedures at all stages of investment, and the rationale underpinning this.	These policies and processes will be defined more closely by the July proposal. The Founder Funds share a clear intent that investment manager appointments will be considered and determined by the Operations Group, and its Portfolio Construction Groups. The Oversight Group will be responsible for ratifying the processes used rather than individual investment manager appointments.
B6	Shared objectives for the pool, and any policies that are to be agreed between participants.	Work has started in these areas and will be reported in July. Part of the initial work will focus on practical policies to achieve fair sharing of transaction costs between Founder Funds across the Brunel CAP to effect the mandate rationalisation needed to deliver savings.
B7	Resources allocated to the running of the pool(s), the governance budget, the number of staff needed and the skills and expertise required.	These matters will be covered in the July proposal. Between them, the Founder Funds have substantial expertise, and redeployment, of role rather than location or employer, will be the primary mechanism used.
B8	Handling of environmental, social and corporate governance policies by the pool.	Project Brunel has begun work on shared investment beliefs to establish common policies to as large an extent as possible. Within the Founder Funds, there is considerable experience and recognised global leadership of responsible investment, broadly defined as generating better returns by investing in companies and assets that contribute to the long term sustainable success of the global economy and society, adopting best practice collective governance with appropriate oversight, prioritisation, delegation and decision making at the right level. Further detail will be provided in the July proposal.
B9	Individual Funds acting as responsible, long term investors through the pool. Determination and enactment of stewardship responsibilities by the pool.	Substantial commonality has been identified between Founder Funds in terms of being long term investors, investing strategically in productive assets that contribute to economic activity, such as equities, bonds and real assets, thereby aiming to earn sustainable and sufficient returns on their assets. The Brunel CAP will provide Sub-Funds for its Founder Funds that enable them to continue this responsible approach. There is recognition that there are some differences between Founder Funds' starting positions on these questions and the development of policies will be mindful of this.
B10	Public reporting of net performance of each asset class by the Brunel CAP, to encourage the sharing of data and best practice.	The Brunel CAP will look to work with other pools to facilitate consistent public reporting of the net performance of each asset class. The Sub-Fund approach will facilitate this. More detail will be provided in July proposal.

Project Brunel: Initial proposal to DCLG on investment pooling

B11	Extent of use by benchmarking by individual Funds to assess their own governance and performance and that of the Brunel CAP, for example by undertaking the Scheme Advisory Board's key performance indicator assessment.	The Brunel CAP will take a fully transparent approach, to facilitate Founder Funds' work in this area. In particular, there is an understanding that overall investment performance will result from a combination of strategic asset allocation decisions taken by Pension Committees and granular Sub-Fund decisions and appointments handled by the Operations Group. More detail will be provided in the July proposal.
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Project Brunel: Initial proposal to DCLG on investment pooling

C. Reduced costs and excellent value for money		Initial proposal, subject to development in the July proposal
C1	<p>Delivery of savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.</p> <p>Approach to comparison of fees and net performance in each listed asset class compare to a passive index.</p>	<p>Project Brunel is establishing a savings projection model. Net savings are expected after the first 2 years, once the balance between operational savings and transitional costs becomes positive.</p> <p>The estimated predictable savings from mandate rationalisation and fee renegotiation when transition is complete, after 10 – 15 years, is £16 million a year across the ten Founder Funds. Additional operational costs, of approximately £1.5 million, including the provision of a unitisation service by a single external custodian, are expected to reduce this. Section 7 of the PwC February Report details the assumptions underlying the savings model.</p> <p>The Founder Funds are open to seeking further savings from specific sources, such as may be delivered by more internal management or more passive management. These approaches are not yet agreed and may be linked to moving some assets into a regulated environment or into national passive procurement or other national initiatives.</p> <p>More widely, the Founder Funds share an aspiration to make the Brunel CAP work for them, and to deploy long term investment approaches consistent with scale. There is an aspiration to make total improvements in net investment return over the Founder Funds of around £70 million a year. The PwC Feasibility Report comments further on the distinction between predicable savings and aspirational improvements.</p> <p>It should be possible to comment on monitoring processes against passive indices in the July proposal, but Project Brunel will seek to work with other pools to establish a consistent approach.</p>
C2	<p>Consideration of setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period.</p>	<p>The Operations Group will draw on the substantial expertise in this area that already exists in the Founder Funds. Each of the Portfolio Construction Groups will be monitored as to their success in setting risk-adjusted long-term targets for active managers.</p> <p>This question will be addressed further in the July proposal.</p>
C3	<p>Transparent assessment of investment costs and fees as at 31 March 2013.</p>	<p>Much of this assessment was originally carried out two years ago in order to inform subsequent renegotiations with investment managers of the South West Funds. Further details will be provided in the July proposal.</p>
C4	<p>Transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.</p>	<p>This assessment has been started. It is designed to feed into the cost savings projection model, which considers scope to achieve fee reductions through mandate rationalisation and increased scale.</p>

Project Brunel: Initial proposal to DCLG on investment pooling

		Detail will be provided in the July proposal.
C5	Detailed estimate of savings over the next 15 years.	To be provided in July proposal.
C6	Detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.	<p>An assessment of implementation costs has commenced as part of the modelling described in C1. This includes legal, tax, procurement advice and costs arising from detailed design, implementation and asset transition. Detail will be provided in the July proposal.</p> <p>There are some legacy illiquid assets that will have to remain outside the pool for contractual reasons. The governance of the assets will be handled by the Brunel CAP Operations Group. It is anticipated that as these investments are run down over the longer term the proceeds released will be transitioned to the pool.</p> <p>In principle, costs will be divided across Founder Funds, either equally or in proportion to relevant assets.</p>
C7	Proposal for reporting transparently against forecast transition costs and savings. Approach to reporting fees and net performance.	To be provided in July proposal.

Project Brunel: Initial proposal to DCLG on investment pooling

D. Improved capacity to invest in infrastructure		Initial proposal, subject to development in the July proposal
D1	Proportion of participating individual Funds currently allocated to infrastructure, both directly and through funds, or “fund of funds”.	<p>The Founder Funds recognise that infrastructure can be an attractive investment class for pension funds with long term, stable cash flows and controlled risks.</p> <p>Between them the Founder Funds have a total strategic target allocation to infrastructure of approximately £820 million as at 31st March 2015. Of this, £580 million is already committed to specific investment and £230 million of this has been drawn down.</p>
D2	Potential development or acquisition of the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or “fund of funds” arrangements.	We recognise that infrastructure can be an attractive investment class for pension funds with long term, stable cash flows and controlled risks. Funds within the Brunel CAP have been allocating to infrastructure since 2007. To maximise our capabilities in infrastructure we will work within the Brunel CAP to build up the focus and capacity on infrastructure, and also seek to collaborate with other pools to support national infrastructure initiatives. Further detail will be provided in the July submission.
D3	Proportion participating individual Funds intend to invest in infrastructure, ambition in this area going forward, derivation of that amount.	<p>All infrastructure investments will need to be acceptable against fiduciary criteria that meet Founder Funds’ overall investment objectives.</p> <p>Within this criterion, and recognising that strategic allocation decisions will remain the prerogative of Founder Funds, Project Brunel plans to work with Founder Funds between February and July to define a substantial ambition to invest in infrastructure. This will enable development of fuller proposals by July.</p>

LGPS Pooling Map

