TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 5

TEESSIDE PENSION BOARD REPORT

1 FEBRUARY 2016

CHIEF FINANCE OFFICER - PAUL SLOCOMBE

REFORM OF LGPS INVESTMENTS – CONSULTATION AND POOLING CRITERIA

1. PURPOSE OF THE REPORT

1.1 To update Members with information on the reform of LGPS investments and the latest consultation and pooling criteria required.

2. RECOMMENDATIONS

2.1 That Members note the report and pass any comment.

3. FINANCIAL IMPLICATIONS

3.1 The financial implications are that there will be a cost of transitioning the assets to the collective investment vehicle, and the management expenses for the Fund will change after the assets are transferred and managed by this new vehicle.

4. INVESTMENT REFORM & CONSULTATION

4.1 On 25 November 2015, the Department for Communities and Local Government published:

- Investment Reform Criteria and Guidance (summary attached as Appendix A); and

  (https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance)

- A consultation - Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (summary attached as Appendix B), and the new draft Regulations 2016.

  (https://www.gov.uk/government/consultations/revoking-and-replacing-the-local-government-pension-scheme)

  (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479562/draft_LGPS__Investment__Regulations_2016.pdf)

4.2 To summarise the required investment reform criteria, strategic asset allocation decisions will remain with individual funds but the management of assets (i.e. buying and selling of shares, bonds, etc., and the construction of the asset portfolio for each asset class) will be managed by the new collective investment vehicle (pools). It is proposed there will be six pools, each with a minimum size of £25 billion.

4.3 The consultation is split into two parts:

4.3.1 Proposal 1 – Adopting a local approach to investments, i.e. changing the current 2009 Regulations from the prescriptive limits on investment assets to a prudential approach. In order to demonstrate a prudential approach, Funds will be required to replace its Statement of Investment Principles with an Investment Strategy Statement which must cover:

- The requirement to use a wide variety of investments (diversification).
- The Fund's assessment of the suitability of particular investment and types of investments.
- The Fund's approach to risk, including how it will be measured and managed.
- The Fund's approach to collaborative investment, including the use of collective investment vehicles and shared services.
- The Fund's environmental, social and corporate governance policy.
- The Fund's policy on the exercise of rights, including voting rights, attached to its investments.

4.3.2 Proposal 2 – Introducing a safeguard (Secretary of State power of intervention); the backstop legislation to ensure all LGPS Funds pool their assets otherwise the Secretary of State will intervene and run the investment function of those Funds who don't pool.

5. EXPECTED TIMELINE

5.1 So far a formal timetable has not been formally announced; however, from information known to date, the expected timeline is as follows:

Consultation (including backstop legislation)	25 Nov 2015
Consultation response and initial pooling proposals	19 Feb 2016
Proposed date for new draft regulations	1 April 2016
Refined and completed pooling submissions	15 July 2016
Administering Authorities to publish a new Investment Strategy Statement (replacing the Statement of Investment Principles)	1 Oct 2016

Establishing collective investment vehicles	1 April 2018
Transfer of liquid assets (estimate)	1 Oct 2018
It is proposed that illiquid assets and existing property are to remain with individual funds until they are either sold or reach termination.*	On-going

* Teesside's main illiquid assets are its direct property portfolio of approx. 25 properties. The DCLG recognises that selling these would incur stamp duty, and therefore be cost detrimental. The other illiquid assets are a few infrastructure and real estate limited partnerships. At present, it is unclear whether these could be managed by the pool on behalf of its Funds on a segregated basis, or by the Funds themselves.

6. INVESTMENT PANEL MEETING – 9 DECEMBER 2015

6.1 At the Panel meeting, it was recommended that:

1) Members note the report and a Special Investment Panel meeting is arranged in early February 2016 before the response to the consultation is required to agree a proposed response.
2) Members decide whether or not to progress options on collaborating with other LGPS Funds in putting together pooling arrangements, and these options to be considered at the proposed February 2016 Special Investment Panel.

6.2 Members agreed to both recommendations. One Member also recommended consultation with the Fund's Employers, particularly the Local Authorities. It was agreed that the other Local Authorities will be kept informed of the consultation/pooling; progress made with the pooling options and the proposed response to the consultation.

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Appendix A

Investment Reform Criteria and Guidance (Summary):

The following criteria set out how administering authorities can deliver against the Government's expectations of pooling assets.

It will be for authorities to suggest how their pooling arrangements will be constituted and will operate. In developing proposals, they should have regard to each of the four criteria, which are designed to be read in conjunction with the supporting guidance that follows. Their submissions should describe:

A. Asset pool(s) that achieve the benefits of scale: The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported. Authorities should explain:

- The size of their pool(s) once fully operational.
- In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
- The type of pool(s) they are participating in, including the legal structure if relevant.
- How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
- The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

B. Strong governance and decision making: The proposed governance structure for the pools should:

i. At the local level, provide authorities with assurance 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;
ii. At the pool level, 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.

Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability. Authorities should explain:

- The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
- The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- Decision making procedures at all stages of investment, and the rationale underpinning this.
- The shared objectives for the pool(s), and any policies that are to be agreed between participants.

- The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
- How any environmental, social and corporate governance policies will be handled by the pool(s).
- How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

C. Reduced costs and excellent value for money: In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so are rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.

Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

As part of their proposals, authorities should provide:

- A fully transparent assessment of investment costs and fees as at 31 March 2013.
- A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- A detailed estimate of savings over the next 15 years.
- A 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.
- A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

D. An improved capacity to invest in infrastructure: Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. 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 proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".

- How they might develop or acquire 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.
- The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

Appendix B

Local Government Pension Scheme: Revoking and replacing the LGPS (Management and Investment of Funds) Regulations 2009 – Consultation:

As stated previously, the consultation is split into two proposals, the first looks to change the strict limits for investment assets and the second gives the Secretary of State for DCLG the power to intervene in managing Funds where it is considered necessary. The questions for each proposal are:

Adopting a local approach to investments – Questions:

1) Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?
2) Are there any specific issues that should be reinstated? Please explain why.
3) Is six months the appropriate period for the transitional arrangements to remain in place?
4) Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?

Introducing a safeguard (Secretary of State power of intervention) – Questions:

5) Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?
6) Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?
7) Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?
8) Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?