TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 10

PENSION FUND COMMITTEE REPORT

13 MARCH 2019

STRATEGIC DIRECTOR: FINANCE, GOVERNANCE AND SUPPORT, JAMES BROMILEY

CONSULTATION ON POOLING

1. PURPOSE OF THE REPORT

1.1 To advise Members of an informal consultation on new statutory guidance on asset pooling within the Local Government Pension Scheme (LGPS), and to ask Members to comment on, and approve a proposed response.

2. RECOMMENDATIONS

2.1 That Members note this report and agree to submit a response to the consultation on behalf of Middlesbrough Borough Council as Administering Authority to the Teesside Pension Fund.

3. FINANCIAL IMPLICATIONS

3.1 There are no specific financial implications arising from this report.

4. BACKGROUND

4.1 The legal framework for investment pooling within the LGPS is set out in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ('the LGPS Investment Regulations') and associated statutory guidance. The current guidance is not particularly detailed in its description of pooling arrangements and consequently there is a wide variation in the approach taken to pooling across the eight LGPS investment pools that currently exist.

4.2 The Ministry for Housing, Communities and Local Government (MHCLG) started an 'informal' consultation by issuing draft revised statutory guidance on investment pooling on 3 January 2019 with a closing date for responses of 28 March 2019 (attached at Appendix A).

4.3 In a foreword to the consultation document MHCLG states that eight pools are now operational and pooling has been a success so far. However "there is still a long way to go to complete the transition of assets and to deliver the full benefits of scale" and that "authorities have requested guidance on a range of issues. The time is now right for new guidance to support further progress".

5. THE DRAFT GUIDANCE

5.1 The draft guidance is more prescriptive about what LGPS investment pooling should look like. For example, each pool must have a pool company or companies to implement the LGPS funds' investment strategies. In general, the approach to pooling set out in the draft guidance closely matches the approach that the Border to Coast Pensions Partnership (and the twelve Funds that own it) has taken to pooling.

5.2 Some other points of note in the draft guidance include:

- Pool companies, which must be regulated by the Financial Conduct Authority (FCA), decide which investment managers to use for pool vehicles, including whether to use in-house of external management. However, the decision on whether to invest in-house or through external management remains with the individual pool members (the LGPS funds).
- Pool governance bodies (the Joint Committee in the case of Border to Coast) should regularly review the provision of services to the pool and the procurement process to ensure transparency and value for money.
- Pool members (LGPS funds) working with the pool company should regularly review the balance between active and passive management in the light of performance net of costs. They should consider moving from active to passive management where active management hasn't delivered better net performance over "a reasonable period". Note, there is no reference in the draft guidance to considering moving from passive to active.
- The draft guidance directs that "those who serve on Pension Committees and equivalent governance bodies in pool members should… take a long term view of pooling implementation and costs. They should take account of the benefits across the pool and across the scheme as a whole, in the interests of scheme members, employers and local taxpayers, and should not seek simply to minimise costs in the short term". This reference to taking accounts of benefits "across the pool and across the scheme as a whole" does not sit easily with the fiduciary duty Committees have to their own LGPS fund.
- Local Pension Boards are recognised as having a "key role in pool governance…They can provide additional scrutiny and challenge to strengthen pool governance and reporting, and improve transparency and accountability for both members and employers." The draft guidance also acknowledges that Boards can provide a source of knowledgeable, experienced people to call upon if pool members want to include observers on pool governance bodies.
- Pool members (individual LGPS funds) are responsible for investment strategy and asset allocation. They should collectively through their pool governance bodies decide the policy on which aspects of asset allocation are strategic (decided at fund level) and which are tactical (decided by the pool company). The draft guidance goes on to state: "Pool governance bodies, when determining where such decisions lie, should be mindful of the trade-off between greater

choice and lower costs and should involve the pool company to ensure the debate is fully informed on the opportunities and efficiencies available through greater scale."

- The draft guidance supports Border to Coast's preferred method of sharing transition costs when setting up a sub-fund between the participating LGPS funds under an assets under management within the new sub-fund basis. This avoids the arbitrary position where one LGPS fund would have much lower transition costs if it was lucky enough to have an external investment manager that was retained as a manager in the new sub-fund.
- The draft guidance sees all assets transferring to pool management with some limited exceptions where the penalty for early exit or transfer of management would be significant. It gives as examples: "life insurance contracts ('life funds') accessed by pool members for the purpose of passive equity investment, and some infrastructure investments. Pool members may also retain existing direct property assets where these may be more effectively managed by pool members."
- Explicit reference is made to LGPS funds making new investments outside of the pool if these relate to local investments, provided the total local investments made by a fund don't normally exceed 5% of that fund's assets and provided the local investment "Be subject to a similar assessment of risk, return and fit with investment strategy as any other investment." This is in line with the Pension Fund's approach to local investments.
- The guidance confirms that administering authorities will need to follow CIPFA guidance when reporting on pooling investments and costs. Unfortunately it then goes on to replicate detail from that guidance. Leaving this in would mean the guidance itself could need changing ever time the accounting CIPFA guidance is changed.

6. PROPOSED RESPONSE TO THE CONSULTATION

6.1 Appendix B to this report sets out a proposed response to the consultation, based on the most significant areas set out in section 5 above. The other eleven funds in Border to Coast are expected to submit responses as well, as is the Border to Coast Joint Committee and the pooling company itself. All these responses are expected to deliver a similar message.

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