



## **Border to Coast Pensions Partnership Ltd – Joint Committee**

**Date of Meeting:** 11<sup>th</sup> March 2019

**Report Title:** Ministry of Housing, Communities & Local Government (MHCLG) –  
Statutory Guidance on Asset Pooling

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### **1 Executive Summary:**

1.1 On 2<sup>nd</sup> January 2019 the Secretary of State for the Ministry for Housing, Communities and Local Government (MHCLG) issued a limited circulation consultation on proposed changes to the current statutory investment pooling guidance issued in September 2016 (attached at Appendix A). The statutory guidance and the proposed changes to it apply to Local Government Pension Scheme (LGPS) Administering Authorities and direct how they are required to invest their assets. As such, the twelve Partner Funds in Border to Coast are all considering whether to make separate responses to the consultation and have shared some draft responses to far. Border to Coast's Board is also making a response. This paper outlines a proposed draft response to the consultation on behalf of the Joint Committee at section 4 which takes into account common elements from draft responses sighted so far, as well as highlighting aspects of the proposed guidance which deal with the role of the Joint Committee.

1.2 The draft guidance is broadly supportive of how Border to Coast has approached pooling. However the draft guidance is much more prescriptive than the existing guidance on how LGPS investment pooling should be approached, and this may require structural change in some of the other LGPS pools. For example, the requirement for every Pool to include at least one Financial Conduct Authority (FCA) entity managing its investments would, if reflected in the final guidance, require changes to at least one other Pool.

### **2 Recommendation:**

2.1 The Joint Committee is asked to agree that a formal response to the consultation should be sent on its behalf based on the comments made in section 4 below. Border to Coast Pensions Partnership Limited is submitting its own response to the consultation, although this paper has been drafted with the assistance of the company to recognise the alignment of interests. Any response provided to the consultation will be on behalf of the Joint Committee itself and not on behalf of the Partner Funds or the company, all of whom can submit their own responses.

2.2 If changes are required to the proposed response, the Joint Committee is asked to delegate the authority to finalise the response to the Chair and Vice Chair of the Officer Operations

Group in consultation with the Chair and Vice Chair of the Joint Committee, with circulation to the Joint Committee by email of any final draft by 21<sup>st</sup> March to allow onward transmission to MHCLG by the deadline of the 28<sup>th</sup> March.

### 3 Background

- 3.1 The reform of investment management in LGPS for England and Wales began in 2015 with the publication of criteria and guidance on pooling of LGPS assets, following extensive consultation with the sector. LGPS administering authorities (including our Partner Funds) responded by coming together in groups of their own choosing to form eight asset pools, one of which was Border to Coast Pensions Partnership.
- 3.2 The stated intention of the latest draft guidance is to clarify several matters raised by Administering Authorities and others (such as by Border to Coast over sharing of transition costs) that have come to light through the implementation to date, and further clarify what MHCLG expects in terms of future progress in the next stage of pooling and reporting / monitoring of associated costs and savings in meeting these obligations.
- 3.3 Once finalised this will replace all matters in the current guidance at pages 7 to 8 of Part 2 of *Guidance for Preparing and Maintaining an Investment Strategy*, issued in September 2016 and revised in July 2017, which deals with regulation 7(2)(d) of the 2016 LGPS Investment Regulations. It also replaces *Local Government Pension Scheme: Investment Reform Criteria and Guidance*, issued in November 2015. As such it will become part of the LGPS regulations and Administering Authorities will have to either follow the guidance or explain and account for any instances where they have not followed it.
- 3.4 Whilst the guidance specifically applies to the LGPS Administering Authorities in England and Wales, Border to Coast will need to be able to support the Partner Funds in adherence and implementation of the final guidance issued.
- 3.5 One significant change of approach from MHCLG evident in the draft guidance is the move to impose a more consistent approach to investment pooling across the LGPS. Comments from Government in previous years had supported an environment where each LGPS Pool and its constituent funds had scope to determine what structure it would use to meet the Government's pooling criteria, provided those criteria were achieved. For example:

“the Secretary of State's power to intervene provides a backstop in circumstances where insufficient progress is being made. In practice, good progress is being made towards pooling and the Secretary of State currently has no intention of intervening” (from a 13<sup>th</sup> October 2016 House of Lords statement in relation to the Government's power to intervene in LGPS investment).

Similarly, from a September 2016 response to consultation on the introduction of the 2016 LGPS investment regulations:

“In the case of the new pooling arrangements, the view is taken that it is appropriate for the Secretary of State to be able to intervene in circumstances where administering authorities are failing to comply with the criteria and guidance on the new pooling arrangements. This power would only be used where there is clear evidence that an authority is failing to comply with regulations, guidance or best practice.”

The draft guidance marks a change of tone and imposes a more uniform approach to the way LGPS investment pooling should operate. This includes requiring each Pool to include a Pool company (or companies) to implement investment strategies, and mandating that these Pool companies are regulated by the Financial Conduct Authority (FCA) with appropriate FCA permissions for regulated activities.

- 3.6 While this is not a specific concern for Border to Coast, and in fact effectively endorses the approach we have taken to investment pooling, it demonstrates a move away from allowing different versions of pooling to co-exist and towards further central control over the approach to investments in the LGPS.
- 3.7 The draft guidance also applies consistency by including a set of definitions in an attempt to clarify the terminology used in pooling, this starts with the following key definitions – shown below alongside an interpretation of what each definition will represent within our Pool:

<b>Definition in draft guidance</b>	<b>Meaning within our Pool</b>
<b>‘Pool’</b> the entity comprising all elements of a Local Government Pension Scheme (LGPS) asset pool	Border to Coast Pensions Partnership
<b>‘Pool member’</b> an LGPS administering authority which has committed to invest in an LGPS pool and participates in its governance	Each of the twelve administering authorities who comprise and jointly own Border to Coast Pensions Partnership
<b>‘Pool governance body’</b> the body used by pool members to oversee the operation of the pool and ensure that the democratic link to pool members is maintained (for example, Joint Committees and officer committees)	Border to Coast Pensions Partnership Joint Committee, together with its supporting groups (such as the Statutory Officer Group and Officer Operations Group)
<b>‘Pool company’</b> the Financial Conduct Authority (FCA) regulated company which undertakes selection, appointment, dismissal and variation of terms of investment managers, and provides and operates pool vehicles for pool members	Border to Coast Pensions Partnership Limited

- 3.8 There are many references to the role of the “Pool governance body” throughout the draft guidance, often stated as working with the Pool company or with reference to the Pool members (individual LGPS administering authorities) working together through the Pool governance body. Taken together this amounts to a significant set of responsibilities, as set out in the table below. However, taking into account the fact that the Joint Committee is currently assisted by other groups, such as the Statutory Officer Group and Officer Operations Group, and work is carried out on its behalf by individual administering authorities as well, the Joint Committee is already undertaking most of the tasks allocated to the ‘Pool governance body’ in the draft guidance.

Ref.	Statement from draft guidance	Current position	Action required for full compliance with draft guidance
3.5	Pool governance bodies, working with the pool company, should regularly review the provision of services to the pool, and the process of procurement, to ensure value for money and cost transparency.	The Joint Committee oversees the investment performance of the Pool company and its investment vehicles. The Pool company has engaged with Pool members and the groups supporting the Joint Committee when carrying out procurement exercises. However no formal regular review process has been carried out yet.	Recommend annual report to Joint Committee from Pool company detailing procurements carried out and value for money evaluation.
4.1	Pool governance bodies should be appropriately democratic and sufficiently resourced to provide for effective decision making and oversight.	Democratic - One Fund one vote. Resources – supported by the other bodies (the company, the Statutory Officers and Officer Operations Groups)	Already fully compliant – no action required
4.6	Local Pension Boards may also provide a group of knowledgeable and experienced people from which observers may be drawn if pool members wish to include observers on pool governance bodies.	A scheme member representative, sourced from the Pool members' Local Pension Boards is a non-voting member on the Joint Committee	Already fully compliant – no action required
4.8	Pool members collectively through their pool governance bodies should decide the pool's policy on which aspects of asset allocation are strategic and should remain with the administering authority, and which are tactical and best undertaken by the pool company. 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.	Creation of sub-funds discussed through the Joint Committee alongside its supporting bodies	Already fully compliant – no action required

Ref.	Statement from draft guidance	Current position	Action required for full compliance with draft guidance
4.9	Where necessary to deliver the asset allocation required by pool members, pool companies may provide a range of pool vehicles and in addition arrange and manage segregated mandates or access to external specialist funds. Pool governance bodies should ensure that their regulated pool companies have in place the necessary permissions to enable pool vehicles to be made available where appropriate.	Scope of FCA regulation reported to the Joint Committee	Already fully compliant – no action required
4.11	Determining where asset allocation decisions lie will not be a one-off decision as pool member requirements will change over time. Pool governance bodies should ensure that a regular review process, which involves both pool members and pool companies, is in place.	Review not required yet (still developing and introducing sub-funds)	Consider annual review process once all planned sub-funds established
5.2	Pool governance bodies, working with pool companies and, where appointed, external transition managers, should seek to minimise transition costs to pool members while effectively balancing speed, cost and timing, taking into account exit or penalty costs and opportunities for crossing trades.	External transition manager and transition monitor have been engaged through joint procurement by Pool company and Pool members to ensure transition costs and timing are managed effectively.	Already fully compliant – no action required
6.4	During the period of transition, while pool governance bodies and pool companies work together to determine and put in place the agreed range of pool vehicles, a pool member may make new investments outside the pool, if following consultation with the pool company, they consider this is essential to deliver their investment strategy. This exemption only applies until the pool vehicles needed to provide the agreed asset allocation are in place.	The Joint Committee, working with Pool company and Pool members can make recommendations on the sub-fund range.	Already fully compliant – no action required

## 4 Response to Consultation

- 4.1 Each individual Administering Authority is able to choose whether to submit its own response to the draft consultation. Border to Coast Pensions Partnership Limited as a Pool company will also submit a response. As a Pool governance body it is also appropriate for the Joint Committee to submit a response. Draft responses from four of Border to Coast's Partner Funds, together with a paper submitted to Border to Coast's Board have been taken into account when preparing the proposed response to the consultation. As would be expected, the responses from all parties involved in Border to Coast will be broadly consistent.
- 4.2 The draft guidance is welcomed and is broadly supportive of how Border to Coast has developed its pooling proposition.
- 4.3 The areas where the guidance is in line with Border to Coast's approach, include
- that all Pool members must pool their assets,
  - the need for an FCA regulated entity at the heart of the pooling proposition (either owned or procured),
  - confirming that strategic asset allocation remains the responsibility of Pool members, recognising their authority's specific liability and cash-flow forecasts,
  - providing definitions to help all when communicating how each Pool works (although these will need some rewording to work for all Pools);
  - clarifying that decision making on selection, appointment and management of asset managers rests with the Pool company,
  - confirming that internal management can be offered by Pool companies, although Pool members can choose whether or not to invest through internal management
  - clarifying that the aim is for reduced costs balanced against risk adjusted returns – so value, not cost, is the key metric
  - highlighting that providing too many asset allocation choices restricts the ability to use scale to drive up value, but recognising there is a need to provide enough choice to provide the diversification needed to meet the Pool members' liability profile and cash flow requirements
  - requiring demonstration of how these considerations have been balanced and that they be kept under regular review,
  - confirmation that a long-term view of implementation costs should be taken, and that Pool members do not seek just to minimise costs in the short term,
  - outlining that transition of existing assets into the Pool should happen as quickly and cost effectively as possible, with transition of listed assets to be undertaken over a relatively short period,
  - providing Government's view that cost sharing of transition expenses (explicit and implicit) is allowable under the regulations
  - requiring that Pool members working with the Pool company, should undertake regular reviews (at least every three years) of retained assets and the rationale for keeping these assets outside the Pool,
  - confirming that although no target has been set for infrastructure allocations, MHCLG expects Pool members to "set an ambition on investment in this area". Pool companies are expected to provide access to infrastructure investment in the UK or overseas or both, with the expectation that over time Pools will move towards "levels

of infrastructure investment similar to overseas pension funds of comparable aggregate size”

4.4 The areas where clarification or tightening of the drafting of the guidance is needed include:-

4.4.1 Paragraphs 5.4 and 5.5 are on one level common-sense. However, for alternative assets such as private equity the description of these arrangements as temporary is unhelpful. Holding a private equity fund to maturity where the initial commitment was made this financial year may well be a 10 year period which is not really temporary. The ability of Pool companies to manage these assets either within pooled structures or simply on behalf of its Pool members will very much depending on the pooling vehicle proposed and the regulatory permissions in place. In our case Border to Coast will, in due course, be offering the ability to transfer such legacy assets into the pooled structure but this may not suit all circumstances and may not be the case for all Pools. It should be acknowledged that ‘temporary’ or ‘interim’ arrangements may in fact last a number of years, until an investment matures.

4.4.2 Para 4.4 - While strongly supportive of the general principle of administering authorities taking a long-term view in relation to the cost/benefit of pooling, there is a general issue in regard to how Administering Authorities can possibly “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”. The legal fiduciary duty each Administering Authority has is towards its own beneficiaries, not to those of the “scheme as a whole”. This could be emphasised by adding to the final sentence in Para 4.3 (additional text shown in italics): “In particular while they have legal responsibilities for the prudent and effective stewardship of LGPS funds *and have a fiduciary duty to the beneficiaries of their respective LGPS funds*, LGPS benefits are not dependent on their stewardship but are established and paid under statute in force at the time.”

4.5 As can be seen from the above, with some matters of clarification, overall the draft guidance is supportive of the approach taken by Border to Coast and its Partner Funds. However, there are two specific areas where changes should be made to the intent / drafting of the proposed guidance:

4.6 Para 3.6 – Monitoring to and Potential Requirement to Move Passive: -

4.6.1 Evidence was provided to highlight and counter the flaws in the consultant research that supported the views held in some parts of Government that passive management was the way forward for the industry, including the LGPS in the early 2015/16 discussions on pooling, so it is disappointing that this has been reintroduced as a key theme.

4.6.2 As such we do not accept the premise behind this paragraph that passive management delivers better net of fees long term risk adjusted returns, but that the only relevant test to the chosen implementation model should be that as set out in the final sentence of this paragraph, “*should seek to ensure performance by asset*

*class net of total costs is at least comparable with market performance for similar risk profiles”*

#### 4.7 Section 8 – 2018 -19 Annual Report and Accounts

4.7.1 Administering Authorities are required to report in line with the CIPFA Guidance on Preparing the Annual Report, the only issue being that this publication is not due to be published until April 2019 when most Funds will already have closed their books and be well on their way to finalising their accounts. Whilst per the regulations the Annual Report does not need to be finalised until December the audit cannot be signed off without it, which means in reality it has to be available in June. Simply put the guidance is too late for application in this reporting period.

4.7.2 Detailed information on reporting requirements should not be included within the draft guidance. It is enough to state that CIPFA guidance should be followed – adding further detail of that guidance just means the overall investment pooling guidance could need amending every time the CIPFA guidance changes in future.

## 5 Conclusion

5.1 Members are asked to agree that a consultation response is provided to MHCLG as set out in section 4 above.

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