Division(s): N/A

PENSION FUND COMMITTEE – 4 DECEMBER 2015

UPDATE ON FUTURE COLLABORATION

Report by the Chief Financial Officer

Introduction

1. As part of the budget statement in July 2015, the Chancellor of the Exchequer announced the Government's intention to work with LGPS administering authorities to develop proposals for the pooling of investments, with the aim of significantly reducing costs whilst maintaining overall investment performance.

2. Subsequently, the Chancellor whilst speaking at the Conservative Conference also set out his wish that the creation of what he called 6 British Wealth Funds, would enable an increased level of investment by LGPS Funds in the infrastructure projects required in this country.

3. The Chancellor's initial statement set out his intention to issue a consultation document this year which would set out the criteria (not subject to further consultation) against which collaboration proposals would be judged, propose changes to the Investment Regulations to ensure there were no restrictions to the proposed collaboration arrangements, and propose backstop legislation to cover those administering authorities who do not come forward with sufficiently ambitious proposals.

4. At the time of writing this report, the consultation document had not been published, but it was hoped to be published by the end of November. An oral update will be provided to this Committee in the event the consultation document is available by the time the Committee meets.

5. It is expected that the consultation document will set out a timescale which will ask all administering authorities to return their proposals, to cover the structure of their new arrangements and the administering authorities they intended to work with, by February 2016 i.e. before this Committee is due to next meet.

Work Undertaken To Date

6. Since the initial announcement by the Chancellor, there have been a series of discussions across the country on how to deliver against the Chancellor's requirements. These discussions have included sessions with officials from Her Majesty's Treasury (HMT) and the Department for Communities and Local Government (DCLG) to determine the criteria against which all proposals will be assessed. It is believed these will cover scale (a minimum size of £25bn has been discussed), cost savings (no targets have been suggested), governance and how approach will facilitate infrastructure investments.

7. These discussions have clarified that all Funds are to be covered by the new arrangements and that there is an expectation from Ministers that the pooling arrangements will cover the vast majority if not all of the assets under management within these Funds.

8. Twenty-five administering authorities have joined forces with the support of Hymans Robertson to undertake a piece of work aimed at producing an objective assessment of the pooling options which can be submitted to the Government. Oxfordshire is represented by Sean Collins within this project. The project is aiming to produce its report before Christmas this year.

9. The project has looked at a number of options including national pools for each asset class, regional pools covering all asset classes, and mixed economy approaches which combine elements of both. The project has undertaken a major data collection exercise with data collected from the majority of Funds outside of London (London was already in the process of analysing their own data as part of the arrangements for the London Collective Investment Vehicle), and from 40 of the largest Fund Managers in the LGPS.

10. In developing any proposals, consideration will have to be given to existing initiatives, including the London CIV, and the joint arrangement proposed by the London Pension Fund Authority and Lancashire. More recently, Surrey, East Riding and Cumbria have also signalled their intention to work together. Whilst the London CIV could be framed to meet the likely scale criteria, the other current initiatives will need to be expanded if they are to fall within the scale criteria.

11. Ministers understand the considerable work involved in setting up the new structures to manage the pooled investments (the London CIV has been in development for over 2 years, and hopes to make its first financial transactions before the end of 2015). It is also understood that for many illiquid assets e.g. private equity, the current investments are likely to be retained through to maturity, so that it could be up to 10 years before all money is invested through the new collaborative arrangements. However, the timescales currently being discussed by Ministers are very challenging, with Ministers keen to see this project maintain momentum and deliver structural solutions during the life of this parliament.

Position for Oxfordshire

12. It is therefore important that this Committee engages now on considering future potential arrangements, so that it is in a position to respond in line with the Government's timescales.

13. One of the key issues to consider is the issue of future governance. The Government have given a clear indication that they do not expect local pension fund committees to be making decisions on the appointment and firing of individual fund managers. At this stage, there has been no further clarification about the extent that local Committees will be able to determine the exact nature of their mandates (e.g. can they determine between

investment styles, benchmarks, targets, etc). It is clear though that the asset allocation decision will remain with the Local Committee i.e. the allocation to each to the broad asset classes.

14. It is therefore key to consider how the governance of any new pooled structure will work in relation to the local committees. At this stage, it is difficult to see how each of the local committees would have an input into the governance of national single asset pools. A national equity pool would have 89 funds participating, and even if the London CIV was to be run outside the national pool, there would still be 57 funds as members.

15. A multi-asset pool is likely to consist of around 10 – 15 funds. Such a size would allow for a joint committee including representation from all member funds to oversee the management of the pool. Such numbers would also have the benefit of enabling the leading officers from each participating fund to work on a collaborative basis to support the work of the pool. Where these multi-asset pools are established on a regional basis, these Governance arrangements will be more practical to arrange.

16. A multi-asset pool which manages all the assets on behalf of 10 – 15 funds would also have the benefit of creating a single relationship between the pooled body and the local committee. Where assets are split between a number of national or asset specific pools, there would be a requirement for multiple relationships between the local committee and the pools in which it was invested. As well as the governance overhead associated with this model, there would be a greater challenge to ensure that the independent decisions taken by the individual pools were consistent with the overall investment strategy of the local committee and in particular their risk appetite.

17. The governance issues are therefore strongly pointing to a multi-asset pool model, which to meet the scale criteria would need to involve 10 to 15 funds. The question of fee savings needs further consideration once the analysis of the data collection through the project supported by Hymans Robertson has been completed. However, there is some analysis that suggests there may be diseconomies of scale if some of the bigger asset classes were grouped in a single national pool, and an argument that economies of scale on the other asset classes could still be delivered by the multi-asset pools working collaboratively e.g. through procurement frameworks, a joint procurement, or a single sub-fund hosted by one of the multi-asset pools.

18. A multi-asset pool is also consistent with the Government's assumed default position of regional pools. The work on the project has suggested that there may need to be a modified version of the pure regional model to take account of some of the existing arrangements, and to ensure like-minded funds can continue to work together. This would include allowing the London Pension Fund Authority to continue to work with Lancashire, avoid splitting up Northamptonshire and Cambridgeshire who together form the LGSS, and allow those funds keen to continue existing internal management arrangements to work with other similar funds.

19. Given its geographic position, the Oxfordshire Fund could look to pool on a regional basis with funds in the South West, the South East or the Midlands. We have engaged in conversations at Officer level with funds in both the South East and the South West, to consider how such arrangements would work for Oxfordshire. It is clear that the Funds in the South West have already undertaken a significant amount of work considering how they may wish to collaborate in the future. Some of the early thinking by these funds has already been presented to each of their respective Pension Committees. An example report from the Avon Fund, which sets out some of the initial thinking and the summary details of the 8 funds, is included as an Annex to this report. More recently the group have been looking to identify a series of sub-funds with different mandates, across which each of the local committee's would allocate their assets.

20. At the current time, the funds under management within the 8 South West Funds falls short of the likely minimum criteria to be set by the Government, and therefore they are open to other like-minded funds joining their arrangement. As a neighbouring authority, and one with an existing arrangement with Gloucestershire through the reciprocal arrangements for the chairing of the Pension Boards, Oxfordshire could be seen as an obvious fund to join the South West arrangements. The initial analysis by officers would suggest that the principles being developed by the South West Funds would be entirely consistent with those the Oxfordshire Fund would be seeking.

Conclusions

21. It is clear from the statements from the Chancellor and government officials, that entering a pooling arrangement will be mandatory, and that they will be looking for a commitment to the future arrangements as early as February next year.

22. Based on our understanding of the criteria against which proposals will be judged, it is likely that a multi-asset pool consisting of 10 – 15 authorities will offer the necessary scale, and cost savings, whilst minimising the governance overhead and indeed deliver improved governance overall through the collaborative working of the responsible officers and members.

23. Outside of the London CIV, the 8 funds within the South West have demonstrated the clearest vision of the way forward, and have developed a series of principles which would be consistent with the model sought by Oxfordshire. The South West Funds will need to find additional like-minded partners if they are to meet the expected minimum scale criteria to be set by the Government.

24. It is therefore proposed that this Committee makes a decision to formally explore the option of joining the 8 funds within the South West to develop a proposal to pool investments as a basis of a shared response to the Government. This work would require the engagement of both officers and Committee Members to ensure that the initial officer assessment of the degree of fit can be confirmed, that any issues can be explored, and where future

decisions are to be taken, the views of Oxfordshire can be included. Such a decision would not commit Oxfordshire to the final outcome if the further work indicated it would not be a suitable option for the Oxfordshire Fund.

RECOMMENDATION

25. The Committee is RECOMMENDED to formally explore the option of joining the 8 funds in the South West (and others as agreed) to develop a proposal for future pooling arrangements in response to the Governments requirements.

Lorna Baxter
Chief Finance Officer

Background papers: None
Contact Officer: Sean Collins, Service Manager, Pensions, Insurance & Money Management, Tel: (01865) 897224

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