

Croydon Council

REPORT TO:	Croydon Pension Board 26 March 2019
SUBJECT:	Local Government Pension Scheme: Draft Statutory Guidance on Asset Pooling
LEAD OFFICER:	Nigel Cook, Head of Pensions and Treasury

1. RECOMMENDATIONS

- 1.1 That the Board note the summary of the consultation which is set out in the text of this report.
- 1.2 That the Board offer any perspective on the issues raised that might add value to the corporate response.

2. EXECUTIVE SUMMARY

- 2.1 This report summarises the MHCLG consultation on the Draft Statutory Guidance on Asset Pooling and suggests a number of issues to be addressed in the Council's response.

3. DETAIL

- 3.1 The Ministry of Housing, Communities and Local Government issued, on 3rd January 2019, an informal consultation on the Draft Statutory Guidance on Asset Pooling. This consultation is open for 12 weeks and will close on 28th March 2019.
- 3.2 This report summarises the consultation, which is appended to this report as Appendix A. The consultation comprises 7 sections. This report discusses each section in turn. Unlike formal consultations there are no questions for consultees to respond to, hence this report will describe the key points from each section and suggest a response.
- 3.3 The guidance sets out the requirements on administering authorities in relation to pooling assets and replaces the section 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 Regulations. It also replaces Local Government Pension Scheme: Investment Reform Criteria and Guidance, issued in November 2015.

Definitions

- 3.4 The consultation specifies a set of definitions for use in the current and future versions of the guidance. These are common sense definitions.

Structure and scale

- 3.5 This section reiterates the aims of pooling, that all administering authorities must pool their assets and that pool members must appoint a pool company or companies to implement their investment strategies, stating clearly, “It is for the pool companies to decide which investment managers to use for pool vehicles”. It also states that a pool company must be a company regulated by the FCA.
- 3.6 It is stated that 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” and “the balance between active and passive management in the light of performance net of total costs. They should consider moving from active to passive management where active management has not generated better net performance over a reasonable period”.

Governance

- 3.7 The Consultation states that pool governance bodies must be established in order to “set the direction of the pool and hold the pool company to account” while pool members through their own governance arrangements will be “responsible for effective governance and for holding pool companies and other service providers to account”. In addition “Strategic asset allocation remains the responsibility of pool members”. It also states Pension Committees should take a long term view of the potential benefits of pooling, taking into account “the benefits across the pool and across the scheme as a whole...and should not seek simply to minimise costs in the short term.” It also notes that Pension Boards can have a role in governance arrangements.
- 3.8 It also states that part of pool governance bodies’ role is to decide the pool’s policy on which aspects of asset allocation are “strategic” and which are “tactical”, with the guidance stating that, “governance bodies should be mindful of the trade-off between greater choice and lower costs”. It is also noted that the position between what is deemed strategic and what is tactical is something that might change over time. It is also states that, “Pool members should set out in their FSS and ISS how they, through the pool governance body, have balanced these considerations and how they will keep this under regular review”.

Transition of Assets to the Pool

- 3.9 There are a number of comments on treatment of costs, including:
“Transition of listed assets should take place over a relatively short period.” and “...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.” And “Inter-authority payments (or other transfers of value) may be desirable in order to share these costs equitably between pool members. The Government’s view is that such payments are investment costs within Regulation 4(5) of the 2016 Regulations, and payments made by a pool member to meet its agreed share of costs may be charged to the fund of that pool member, whether the payments are made to other pool members, the pool company, or another body by agreement.”
- 3.10 It is noted that “In exceptional cases, some existing investments may be retained

by pool members on a temporary basis” citing assets that need to be held to maturity as an example. It also notes that “Pool members may also retain existing direct property assets where these may be more effectively managed by pool members” and “...pool members may retain the management of existing long term investment contracts where the penalty for early exit or transfer of management would be significant. These may include life insurance contracts (‘life funds’) accessed by pool members for the purpose of passive equity investment, and some infrastructure investments.”

- 3.11 For assets held outside the pool it is stated 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.”

Making New Investments Outside The Pool

- 3.12 There is an expectation that new investments will be made through the pool company with 2020 being set as the target timescale and a statement that “pool members should make new investments outside the pool only in very limited circumstances.”
- 3.13 Exceptions (to pool members investing in their own pool) include, “A small proportion of a pool member’s assets may be invested in local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member”, with clarity that Local assets should, “not normally exceed an aggregate 5% of the value of the pool member’s assets at the point of investment and be subject to a similar assessment of risk, return and fit with investment strategy as any other investment.”; or “may investin a pool other than their own where collaboration across pools or specialism by pools can deliver improved net of fee returns”.

Infrastructure Investment

- 3.14 There are a number of infrastructure related aspects noted in the document. Although supportive of the asset class, the consultation states, “There is no target for infrastructure investment for pool members or pools, but pool members are expected to set an ambition on investment in this area.” “Government expects pool companies to provide the capability and capacity for pools over time to move towards levels of infrastructure investment similar to overseas pension funds of comparable aggregate size”.
- 3.15 It is explicitly stated that Pools are expected to provide a range of options to accessing the asset class and may offer brown and greenfield exposure to the asset class. There is also comment that, “Pool members may invest in their own geographic areas but the asset selection and allocation decisions should normally be taken by the pool company in order to manage any potential conflicts of interest effectively, maintain propriety, and ensure robust evaluation of the case for investment”. The consultation states for the purpose of annual accounts CIFPA’s definition for the asset class should be used (which includes a comment that conventional property is not normally included). The consultation also makes it clear that residential property is defined as infrastructure.

Reporting

- 3.16 There are a number of cost and pooling related requirements, including stating that, “Pool members are required to report total investment costs and

performance against benchmarks publicly and transparently in their annual reports, following the CIPFA guidance: Preparing the Annual Report, with effect from the 2018-19 report.”

- 3.17 The CIPFA guidance is also to be used when it comes to defining which assets are to be deemed pool assets, “pooled assets’ are those for which implementation of the investment strategy – i.e. the selection, appointment, dismissal and variation of terms for the investment managers (including internal managers) – has been contractually, transferred to a third party out with the individual pension fund’s control.” Pool members should “provide a rationale for all assets continuing to be held outside the pool, including the planned end date and performance net of costs including a comparison which costs of any comparable pool vehicles. They should also set out a high level plan for transition of assets.”
- 3.18 It is stated that the Scheme Advisory Board (SAB) will publish an annual report on the pools based on data from the pool member annual reports. It is also stated that pool companies should report in line with the SAB Code of Cost Transparency, with pool companies requiring their internal and external investment managers to do likewise. The final point on the consultation is to state that “Pool members are required to report any change which results in failure to meet the requirements of this guidance to the LGPS Scheme Advisory Board (SAB) and to MHCLG.”

Croydon Response

- 3.19 The recommendation of this report is that a response is drafted to reflect the views of the Committee members and dispatched in the name of the Chief Finance Officer in consultation with the Committee Chair and the Cabinet member for Finance and Resources. The following section suggests areas that should be addressed by this response.
- 3.20 There is an underlying assumption that investments made through the Pooling Company will ‘maximise the benefits of scale’; this, it is evident from the language in the consultation, is synonymous with value for money. However, there is no evidence to support this argument, indeed it is a fundamental principal within the investment universe that no investment fund can maintain a predominant position, compared with their peer group, over any period of time. In adopting this approach the significant due diligence that backs up each investment decision – whether undertaken by investment advisors, specialized consultants, or individual authorities – is given less weight than it should. The consultation puts an onus on the authority to ‘undertake regular reviews of retained assets and the rationale for keeping these outside the pool.’ This should also apply for assets held by the pool. This consultation, contentiously, revisits the debate about active and passive management: this has no place in this consultation process. The same could be said for the comments around greenfield and brownfield infrastructure projects.
- 3.21 On the broad issue of cost control and transparency the inclusion of the assumption of use of the National LGPS Framework is welcome.
- 3.22 Under the proposed reporting arrangements the Pension Fund’s investments with LGIM would not count as being pooled. This contradicts the previous

reporting arrangements. Further, reporting in line with the Code of Transparency will be challenging as, at present, private market funds fall out of scope. For Croydon this is 25% of the portfolio.

3.23 The section on making new investments outside of the pool has particular relevance here. Following the formulation of a revised investment strategy the Pensions Committee:

- Will only be able to 'make new investments outside the pool only in very limited circumstances;
- Invest in local initiatives only up to an aggregate 5% of the value of the Pension Fund; and
- Be required to consult with the London CIV on any investments outside of the pool.

This raises certain issues around the sovereignty of local decision making bodies.

3.24 A radical departure from the line of development to date is that 'pool members may invest through pool vehicles in a pool other than their own.'

3.25 Finally, it should be noted that the consultation is silent on ESG issues.

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BACKGROUND DOCUMENTS:

Appendices

Appendix A: Statutory Guidance on Asset Pooling in the Local Government Pension Scheme.