

Report for: Pensions Committee 14th January 2016

Item number: 10

Title: Pooling Consultation and Revisions to Investment Regulations

Report authorised by: Tracie Evans, Chief Operating Officer (CFO)

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Ward(s) affected: N/A

**Report for Key/
Non Key Decision:** Non Key decision

1. Describe the issue under consideration

1.1 The Government have published two documents that will have a profound impact on the management of LGPS investments. This note discusses these documents and the actions required to meet the new requirements.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 The Committee is invited to:

- (a) Note the actions required and timetable to comply with the revised investment regulations,
- (b) Approve the draft response to the pooling criteria, and
- (c) Delegate authority to the Chair to submit a response to the investment regulations consultation on behalf of the Committee if she considers it appropriate to do so.

4. Other options considered

4.1 As discussed in the paper. In particular choices and options will emerge as to selection of pools, timing of transfers and assets to be managed outside of pools.

5. Background information

5.1 The Government has published two documents concerning the management of Local Authority Pension Scheme investments. These relate to:

- a) Consultation on revisions to the investment regulations and new Government powers of intervention.

b) Timetable for submission and content of plans for pooling investments and criteria for judging acceptability of pooling proposals submitted.

5.2 The attached note (appendix 1 to 3), which was circulated earlier to the Committee discussed the proposed changes to the management of pension scheme investments. Actions required are discussed below.

Investment Regulations

5.3 The revised draft investment regulations are attached (appendix 4). In essence they replace hard limits with a decision framework based around an Investment Strategy Statement that replaces the Statement of Investment Principles. The changes have been welcomed by all commentators and will provide increased flexibility when developing strategy.

5.4 If the Committee wish to comment, these should be submitted by 19th February 2016. If as expected the regulations come into force on 1st April 2016, the first Investment Strategy Statement will be required six months later, 1st October 2016.

5.5 Within the draft regulations are new government powers of direction over the management of investments. These proposed new powers are discussed in appendix 1. The Committee may wish to leave open the possibility of a consultation response on the intervention powers or the proposed guidance on exclusionary policies as views emerge from the LGPS community. If so, it is suggested that the Committee delegate authority to the Chair to submit a response on behalf of the Committee if she considers it appropriate to do so.

Pooling Criteria

5.6 Each Administering authority is required to submit proposals for pooling, which the Government will assess against the criteria in this document (appendix 3). The Government is looking for up to six funds, each with assets of at least £25bn with statements on the capacity to invest in infrastructure.

5.7 Initial responses on the approach being taken to pooling are required by 19th February 2016 with fully developed responses required by 15th July 2016. As set out in appendix 3 the level of detail required to be submitted is substantial and will take time to gather.

5.8 Haringey's participation in the London CIV if extended to all or virtually all of our investments will most likely be consistent with the pooling criteria. The CIV has indicated that it will provide much of the detail for the response and will offer a group response with some additional statements from individual authorities. If this approach is followed, the effort required to respond will be minimized.

5.9 LGPS funds outside of London are currently considering how to meet the requirements of the pooling criteria with groupings (not all regional) starting to emerge with participation offers being made to all other funds. It is expected that the London CIV will be the core of the Haringey pooling response, but it appears unlikely that the CIV can offer best in class arrangements for all assets classes. Thus there are benefits to maintaining a watching brief over the other pools being developed and including within the initial response a

preference for flexibility in selection of pools. The deadline for submitting detailed pooling proposals (15th July 2016) is insufficient to allow time for pools that emerge to be assessed and compared, which is another possible comment within the first response.

- 5.10 The proposed first response on pooling, to be submitted by 19th February 2016, is attached (appendix 5.)

6. Comments of the Chief Finance Officer & financial implications

- 6.1 The Government's proposed changes to the management of LGPS investments has a central goal of improved financial outcome through lower fees and better performance at its heart. The proposals will curtail the powers of the Committee to select investment managers and potentially to set strategy. Implementation of strategy will be through investments pools and the selection of pools will determine implementation choices. The Committee may have difficult choices when (not if) it is forced to pool its actively managed assets.

7. Comments of the Assistant Director of Corporate Governance Implications

- 7.1 The Assistant Director of Governance has been consulted on the content of this report. There are no specific legal implications arising from this report

8. Comments from the Independent Advisor

- 8.1 As stated at Section 5 of this report the Government has produced two documents, on revisions to the Investment Regulations/powers of intervention and the Pooling of Investments.
- 8.2 The proposal in the Investment Regulations Consultation to remove Schedule 1 is very welcome. The existing Schedule 1 (to the LGPS (Management and Investment of Funds) Regulations 2009 (As amended)) places arbitrary restrictions/limits on the investment options of LGPS Funds and is more restrictive than the approach applied to private sector Defined Benefit Schemes. In addition given the current Regulations specifically "list" some types of investment but not others there was some question as to the extent that LGPS Funds could legitimately utilise certain vehicles such as derivatives. The current consultation proposes the removal of Schedule 1 and its replacement by a prudential risk based approach.
- 8.3 A move to a risk based regime similar to that applicable to private sector Pension Funds will place a duty on LGPS Funds to base investment decisions on risk assessment with a requirement to manage their investment risks and meet their long term objectives without limits on particular investment approaches. Under the new draft Regulation 7 each LGPS Fund will be required to produce an **Investment strategy statement** which sets out its approach to investment (and will replace the existing requirement for a "Statement of Investment Principles"). This is an extremely positive proposal which LGPS Funds should clearly welcome in any response.
- 8.4 The draft 2016 Regulations include as draft Regulation 8 **Directions by the Secretary of State**. This draft regulation introduces a power for the Secretary of State to take control of the investment functions of a Fund if the Fund fails

to have regard to guidance issued under draft Regulation 7(1) which relates to the formulation of the Investment Strategy Statement. The Consultation document indicates that one reason for the Secretary of State to issue a Direction (under draft Regulation 8) would be where a Fund fails to participate in one of the large asset pools (which are approved by the Secretary of State) or proposes a pooling arrangement that does not adhere to the pooling criteria and guidance. While the introduction of a specific power of Direction is a retrograde step and in contrast to the investment strategy “freedoms” proposed in the Consultation and draft Regulations (see 8.2 and 8.3 above) this was inevitable given the Government’s determination to move to pooling of the management of LGPS Investments. The draft Regulations do however state (Regulation 8(3)) *“Before making a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must consult the authority concerned.”* and (Regulation 8(4)(c)) that in reaching any decision the Secretary of State must have regard to *“any representations made by the authority in response to the consultation under paragraph (3).”* In any response to this Consultation I suggest that the Fund support the proposed wording of draft regulation 8(3) and 8(4)(c). If the Fund wishes to respond to the Investment Regulations Consultation it has until 19 February 2016 to do so.

- 8.5 The document **“Local Government Pension Scheme: Investment Reform Criteria and Guidance”** sets out the criteria for the pooling of LGPS investments and requires each Fund to submit proposals for pooling. Initial responses are required by 19 February 2016 and *“refined and completed submissions”* by 15 July 2016.
- 8.6 It is interesting to note that throughout the document “Local Government Pension Scheme: Investment Reform Criteria and Guidance” reference is made to Funds and *“pool(s)”* rather than Funds and a *“pool.”* This clearly indicates that there is no expectation that any Fund will pool all its assets (required to be pooled) with only one pool. Indeed given the number of Funds (89 in England and Wales) and the multiplicity of approaches across and within asset classes amongst them it would not be surprising if any individual Fund comes to the conclusion that any one Pool is unlikely to meet all their investment requirements optimally.
- 8.7 It should also be remembered that Pools exist merely to meet the investment management needs of Funds. No particular Pool based in any particular region has the absolute right itself to manage assets on behalf of any Fund. Individual Funds remain the ultimate owners of their assets (even after pooling) and it should be a decision for each Fund to determine which assets are allocated to which Pool(s). Therefore taking note of the points made in 8.9 and 8.10 I strongly concur with the statement at 5.9 of this report that *“there are benefits to maintaining a watching brief over the other pools being developed and including within the initial response a preference for flexibility in selection of pools.”*
- 8.8 It is interesting to note the proposed timetable for the transfer of assets to Pools in the Investment Reform Criteria and Guidance document. Section 2.5 clearly states that immediate transfer of assets to Pooled arrangements is neither required nor anticipated. The document states *“It is expected that liquid assets are transferred into the pools over a relatively short timeframe, beginning from April 2018.”* Therefore the Government do not expect pooling of assets to necessarily commence until over two years from now.

Consequently the Fund should feel no obligation whatsoever to make any rapid decisions regarding the pooling of its assets.

9. Equalities and Community Cohesion Comments

9.1 Not applicable.

10. Head of Procurement Comments

10.1 Not applicable.

11. Policy Implications

11.1 None.

12. Use of Appendices

12.1 Appendix 1: Detailed note on investment regulations and pooling criteria.

Appendix 2: Investment Regulations - Consultation Questions

Appendix 3: Detail to be contained within Pooling Response

Appendix 4: Draft investment regulations

Appendix 5: Draft response to Pooling Criteria

13 Local Government (Access to Information) Act 1985

13.1 Not applicable.