

**JOHN RAISIN FINANCIAL SERVICES LIMITED**

**London Borough of Haringey Pension Fund**

**Observations on the draft LGPS Statutory Guidance on  
Asset Pooling issued 3 January 2019**

**A paper by the Independent Advisor  
January 2019**

**Background to the draft Statutory Guidance**

In November 2015 the Government issued the *“Local Government Pension Scheme: Investment Reform Criteria and Guidance.”* This document provided guidance to the LGPS on the creation of Asset Pools. Based on this guidance the LGPS Administering Authorities across England and Wales came together to form eight Asset Pools. The Haringey Fund chose to join the London CIV pool. The Statutory Guidance of July 2017 on *“Preparing and Maintaining an Investment Strategy Statement”* includes approximately a page on asset pooling but this is general/broad in nature and does not address issues that have arisen as Asset Pools have developed since 2015.

The experience of pooling since 2015 particularly in the context of the wide spectrum of approaches adopted by both the eight Asset Pools and by the (now) 87 LGPS Funds in England and Wales has necessarily resulted in the issuing of detailed new draft **Statutory Guidance on Asset Pooling** by the Ministry of Housing, Communities and Local Government (MHCLG) on 3 January 2019.

The consultation period is twelve weeks and will close on 28 March 2019. After consideration of responses to the Consultation the MHCLG will then proceed to issue actual **Statutory Guidance on Asset Pooling**.

**Independent Advisor’s Opening Comments**

The covering e mail which accompanied the draft Statutory Guidance included the statement *“As you may know, MHCLG has been preparing new statutory guidance on LGPS asset pooling. This will set out the requirements on administering authorities, replacing previous guidance, and builds on previous Ministerial communications and guidance on investment strategies.”*

New guidance on Asset Pooling is clearly required. The November 2015 Guidance was issued in the context of forming Asset Pools. Since then eight Asset Pools, which overall are clearly diverse in both their structure/governance and approach have been formed and are now all operational. Consequently, new Guidance is required both in the light of experience, in response to issues that have arisen so far, and to help ensure Asset Pooling is genuinely effective and successful in the long term.

Furthermore, the Guidance issued in November 2015 does not have the status of Statutory Guidance. In contrast the 2019 Guidance when issued in final form will have the status of Statutory Guidance issued by the Secretary of State under Regulation 7(1) of the LGPS (Management and Investment of Funds) Regulations 2016. In simple terms Administering Authorities such as the London Borough of Haringey must follow Statutory Guidance except where it judges on admissible grounds that there is good reason not to do so, but without the freedom to take a substantially different course. Consequently the 2019 Guidance when finalised will normally need to be followed by all LGPS Funds and will therefore put in place a clearly defined framework for Asset Pooling.

This paper makes observations and comments on the draft Statutory Guidance issued on 3 January 2019 to assist the Pensions Committee and Board to understand its potential implications. The paper has been written for the Haringey Fund and therefore focuses on those parts of the draft Statutory Guidance that may be of particular interest/relevance to this LGPS Fund. It also makes some suggestions as to how the draft might be amended and improved. Each area of the draft Statutory Guidance is examined in turn below:

## **Foreword**

In this section *“the hard work and commitment of people across”* the LGPS in progressing all eight Asset Pools to operational status is acknowledged. It is also stated that *“In the light of experience to date with pooling and the challenges ahead.....The time is now right for new guidance to support further progress.”*

## **Introduction**

The Introduction makes it clear that the guidance when finalised will be Statutory Guidance and includes the statement that *“This guidance sets out the requirements on administering authorities in relation to the pooling of LGPS assets.....Administering authorities are required to act in accordance with it.”*

## **Definitions**

The guidance introduces a set of definitions *“for use in this and future guidance”* in relation to Asset Pooling – *Pool, Pool member, Pool governance body, Pool company, Pool fund, Pool vehicle, Pooled asset, Retained asset, Local asset.* These definitions are extremely helpful in clarifying the requirements and expectations of the MHCLG in relation to Asset Pooling.

## Structure and Scale

Section 3.2 makes it clear that *“the selection, appointment, dismissal and variation of investment managers” “must”* going forward be a matter for the Asset Pool not individual Administering Authorities (LGPS Funds).

Section 3.4 states that a Pool Company (which is the body that undertakes the selection, appointment, dismissal and variation of terms of investment managers) *“must be a company regulated by the Financial Conduct Authority (FCA) with appropriate FCA permissions for regulated activities.”* This would appear to resolve the question as to whether or not each Asset Pool needs to set up/utilise an overarching FCA regulated company as part of its Governance arrangements.

Although seven of the eight Asset Pools, including the London CIV, have so far set up/utilised an overarching FCA regulated company the Northern Pool which consists of the Greater Manchester, West Yorkshire and Merseyside Funds (respectively the first, third and fourth largest of the 87 LGPS Funds in England and Wales) has not yet done so. The three Funds have made a very clear and cogent case, that due to their scale and their low costs, it is very clearly not cost effective for the Northern Pool to establish such an overarching FCA regulated company. They have, however, also previously stated that this will be regularly reviewed.

## Governance

Sections 4.1 to 4.6 are concerned with pool governance bodies. Section 4.1 makes it absolutely clear that Asset Pools are and must be accountable to their constituent LGPS Funds stating that *“Pool members must establish and maintain a pool governance body in order to set the direction of the pool and to hold the pool company to account. Pool governance bodies should be appropriately democratic and sufficiently resourced to provide for effective decision making and oversight.”*

The draft Statutory Guidance does not, however, state that Employee representatives *“should”* be included in the membership of pool governance bodies. This omission is surprising given both that the LGPS exists to provide pension benefits to those employed in local government (and organisations with a community of interest with local government) and the requirements of the Public Service Pensions Act 2013 and the LGPS Regulations 2013 (As amended) that Employee representatives must be included in the governance arrangements of LGPS Funds through, at least, their representation on Local Pension Boards. The insertion of a statement that pool governance bodies *“should”* include a proportion of Employee representatives (perhaps a third or a quarter) would clearly enhance the governance of Asset Pools by enhancing the diversity of experience and perspective of the membership of these bodies.

The LGPS Scheme Advisory Board for England and Wales (SAB) has however previously indicated its support for the inclusion of Employee representatives on pool governance bodies. In May 2018 the SAB issued an updated Statement on Pool Governance which clearly encouraged *“the consideration of direct representation on oversight structures”* of Employee representatives and concluded with the statement that ***“In line with the UK Corporate Governance Code principle of ‘comply or explain’, any pool making a decision to exclude member representatives from their formal oversight structures should publish this decision and formally report the reasons to the local pension boards which the pool serves.”*** At present the London CIV Shareholder Committee (the London CIV pool governance body) consists of eight Councilors and four Treasurers. There are, however, no specific Employee nominated representatives or representatives of non Council Employers.

The fact that individual LGPS Funds remain responsible for strategic asset allocation is clearly stated at both sections 4.2 and 4.7. Section 4.2 includes the statement that *“Strategic asset allocation remains the responsibility of pool members, recognising their authority’s specific liability and cash-flow forecasts.”* Section 4.7 includes the statement that *“Pool members are responsible for deciding their investment strategy and asset allocation and remain the beneficial owners of their assets.”*

One potentially major issue that the draft Statutory Guidance is silent on is the provision of *“proper advice”* that individual LGPS Funds must take in formulating their Investment Strategy Statement under Regulation 7 of the LGPS (Management and Investment of Funds) Regulations 2016. At least one Asset Pool is already understood to be providing advice on investment strategy (and therefore *“proper advice”*) to its constituent LGPS Funds and this approach may be embraced by other Asset Pools. Such an approach would appear to be not merely inappropriate but contrary to the overall intention of asset pooling within the LGPS which is to realise the benefits of scale in the implementation of individual LGPS Funds investment strategies. If Asset Pools provide *“proper advice”* to their constituent LGPS Funds then in effect the Asset Pool will have a major and potentially decisive influence over the strategic asset allocations of the organisations they have been created to serve. This would in effect be *“the tail wagging the dog.”* Therefore, it would appear both logical and highly desirable that a statement be included in the final version of the Statutory Guidance that Asset Pools *“must not”* provide *“proper advice”* to any LGPS Fund in relation to decisions made by an LGPS Fund under Regulation 7 of the LGPS (Management and Investment of Funds) Regulations 2016.

There is clearly a question as to which aspects of investment strategy are *“strategic”* and are therefore the responsibility of each individual LGPS Fund and which are, in the words of the draft Statutory Guidance *“tactical and best undertaken by the pool company.”* The draft guidance (Section 4.8) clearly indicates that the decision as to what is *“strategic”* and what is *“tactical”* is not a decision for the Asset Pool (for example the London CIV) but for *“Pool members collectively through their pool governance bodies.....”* This is both a very clear

statement and reminder that the Asset Pools exist to deliver services to their constituent LGPS Funds and that they must not seek to impose any interpretation of “*strategic*” and “*tactical*” investment on their constituent Funds.

### **Transition of assets to the pool**

This section is clear that individual LGPS Funds must implement asset pooling and leaves no discretion for individual LGPS Funds to unnecessarily or unduly delay the pooling of the vast majority of their assets. Such an approach is clearly necessary if the benefits of asset pooling to the LGPS as a whole are to be achieved.

The draft Statutory Guidance is however also clear that “*In exceptional cases, some existing investments may be retained by pool members on a temporary basis. If the cost of moving the existing investment to a pool vehicle exceeds the benefits of doing so, it may be appropriate to continue to hold and manage the existing investment to maturity before reinvesting the funds through a pool vehicle.*” (see section 5.4) and that individual LGPS Funds “*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.... some infrastructure investments.....*” (see section 5.5).

### **Making new investments outside the pool**

The contents of this section (see sections 6.1 and 6.4) seek to clarify and in effect minimise the ability of individual LGPS Funds to themselves procure asset manager services and includes the statement (see section 6.1) “*Pool members should normally make all new investments through the pool company in order to maximise the benefits of scale..... From 2020, when new investment strategies are in place, pool members should make new investments outside the pool only in very limited circumstances.*” These provisions are logical if the potential benefits of asset pooling to the LGPS as a whole are to be achieved.

### **Infrastructure investment**

This section clarifies that while asset pooling was intended to facilitate infrastructure investing and the government expects pools to provide increased “*capability and capacity*” for infrastructure investment “*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.....*”

Sections 7.4 and 7.5 provide a definition of infrastructure assets which (helpfully) is both clear and broad and confirms that “*all residential property is included in this definition of infrastructure.*”

Section 7.3 includes the statement *“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.”* Interestingly this statement accords with the approach that the Haringey Joint Committee and Board has taken with regard to residential property as shown by its discussions and decisions at the meetings held on 13 September and 20 November 2018.

## **Reporting**

To evidence whether, in quantitative terms, asset pooling has been successful, and, if so, to what extent then clear, extensive and robust reporting is necessary. Section 8.1 of the draft Statutory Guidance therefore requires that each LGPS Fund report a wide range of data (see sections 8.2 and 8.3) *“.....publicly and transparently in their annual reports”* following CIPFA guidance.

Section 8.7 clearly and explicitly indicates the importance that the MHCLG attaches to investment cost transparency stating *“Pool members should ensure that pool companies report in line with the SAB Code of Cost Transparency. They should also ensure that pool companies require their internal and external investment managers to do so.”*

## **Independent Advisors Conclusion**

The draft Statutory Guidance is, as a whole, positive and helpfully provides definition and clarity in respect of a number of important issues relating to Asset Pooling. There are, as indicated in the section on Governance above, however some areas where the draft Statutory Guidance could clearly be enhanced. Given the profile that Asset Pools have already achieved it is both timely and welcome that the draft Statutory Guidance unequivocally confirms that the Asset Pools are instruments for the implementation of investment strategy and the responsibility for determining investment strategy and asset allocation remains with the individual LGPS Funds.

## **John Raisin**

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