

HERTFORDSHIRE COUNTY COUNCIL

PENSION COMMITTEE

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ACCESS LGPS ASSET POOLING

Report of the Director of Resources

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1. Purpose of report and Summary

- 1.1 The purpose of this report is to provide members of the Pension Committee with an update on the progress of the ACCESS pooling submission to Government which is expected by 15 July 2016.
- 1.2 This report also provides members with an update on the amendment of the investment regulations, a consultation that was issued by Department for Communities and Local Government's (DCLG) in November 2015.

2. Summary

- 2.1 Following the agreement to work with ACCESS, Hertfordshire County Council officers and the Pension Committee Chair have been involved in a significant number of meetings to progress this work and in particular the structure and governance of the legal entity which will be at the heart of the ACCESS proposal. A great deal of research has been undertaken to develop this work and this has included officers meeting a number of legal firms and City institutions to discuss the legal structure and governance of the asset pool.
- 2.2 In order to make the submission there are four main issues to be addressed by each pool. In the investment reform criteria and guidance issued by DCLG in November each pool submission will be assessed against four criteria which are as follows:
 - Size (at least £25bn in assets under management)
 - Governance
 - Reduced fees and “value for money”
 - An increased capacity for investing in infrastructure

The pool has already met the first of these tests and significant focus has been made in trying to resolve the shape of the governance and structure of the entity from which all other decisions will flow. Any such structure must meet the requirements of DCLG and HMT. This report sets out the ACCESS proposal

with regards to the governance of this model and also provides an update on how the other criteria are being addressed.

- 2.3 The requirement for Funds to revise and put in place new investment strategies following the introduction of new investment regulations has been deferred by DCLG for the time being, recognising the additional work that Funds are doing on asset pooling. Members will be kept apprised of developments in this area as the revised regulations will need to be put in place in order to facilitate asset pooling.

3. Recommendations

- 3.1 The Pension Committee notes the extensive work undertaken by officers and the Chairman of the Pension Committee in progressing the ACCESS pool submission with other ACCESS members.
- 3.2 The Pension Committee affirms the decision reached by the ACCESS Pension Committee Chairs outlined in section 6 to progress the Collective Investment Vehicle, option 1.
- 3.3 The views of the Pension Committee are sought in relation to the ultimate governance structure and whether the operator should be rented or built to inform the next meeting of ACCESS chairs in June.
- 3.4 That the Pension Committee agrees an additional meeting in July, to facilitate the review and approval of the ACCESS pool submission.

4. Background

- 4.1 In order to progress the work and required research to develop the ACCESS pool submission a detailed project plan has been developed by officers with the help of Hymans Robertson who are also providing project management and support, a progress report from Hymans is attached as appendix A. The project plan is made up of four work streams addressing each one of the criteria that the Pool is required to address in its submission. There is a lead officer for each work stream and each lead is supported by a number of other ACCESS officers. Hertfordshire officers are making contributions to all of these work streams in particular the work streams on governance and infrastructure.
- 4.2 Engagement with members of each Fund is through monthly meetings of the Chairs of the Pension Committee. The key purpose of these meetings is to update elected members on progress and seek approval on key decisions based upon officer proposals put before them for further recommendation to local pension committees.
- 4.3 ACCESS officers in looking at potential models for asset pooling have commissioned legal advice from a number of legal firms as well as holding meetings with a number of City institutions such as investment managers, transition managers, custodians, investment consultants and companies who have set up an investment management company to pool assets such as the London CIV.

- 4.4 There have also been a number of meetings with other pools in the form of cross-pool meetings to share learning and knowledge and look at particular criteria such as infrastructure so that a common approach can be adopted in pooling submissions.
- 4.5 The ACCESS proposal has also been informed by feedback from the Minister and emerging views from DCLG and HMT through meetings with government officials. Sections 5 – 8 of this report set out further detail of the progress of the ACCESS pool in meeting the pool submission criteria.

5 Criteria A: Scale

- 5.1 The ACCESS pool of 11 LGPS funds has assets under management of just over £33bn which meets the criteria set out by government on expected size of pools (£25bn).
- 5.2 Each pool is required to provide a summary of assets which are proposed to be held outside the pool and the rationale for doing so. The Government recognises that there are certain assets that cannot initially be pooled due to the nature of the legal agreements entered into and the illiquidity of those assets. The assets that that the Hertfordshire Fund will hold outside the Pool are the private equity investments we hold with HarbourVest, SL Capital, Pantheon and some of the private equity and real estate investments in the LGT alternatives mandate. In addition the Fund will hold cash of £35m outside the pool for operational purposes. Table 1 summarises the private equity and real estate investments that will be held outside the Fund with outstanding commitments of £117m (3.4% of the total assets of the fund).

Table 1: Private Equity and Real Estate holdings at 31 March 2016

Private Equity Manager		Commitment in base currency	Drawdowns to 31/03/16 in base currency	Outstanding commitment at 31/03/16 in base currency
		£	£	£
<u>Investment Managers</u>				
Standard Life	Total	81,662,597	70,403,613	11,258,984
HarbourVest	Total	149,990,955	123,837,650	26,153,305
TTP	Total	2,000,000	2,000,000	0
Permira	Total	12,020,486	12,020,486	0
Pantheon	Total	29,604,119	2,375,893	27,228,226
LGT	Total	78,692,566	26,613,770	52,078,796
	TOTAL	353,970,723	237,251,412	116,719,310

6. Criteria B: Governance and decision making

- 6.1 The ACCESS pool is required to set out in its submission how its pooling structure will operate and the legal structure of that entity. The criteria issued by Government was silent on the type of legal structure the Government expected to see in each pooling submission; however, subsequent dialogue and meetings with HMT and DCLG officials has made it clear that they expect to see a

Financial Conduct Authority (FCA) regulated entity at the heart of any submission. For the purposes of this report the collective management of assets in a collective investment scheme such as a pool is a regulated activity and would be subject to oversight and regulation by the FCA in its role as the regulator of the UK's financial markets

- 6.2 To support the analysis of potential models for asset pooling, ACCESS officers commissioned legal advice and held a number of meetings with lawyers and City institutions to gain an understanding of how these different investment management structures and their governance would work in practice. They then reviewed the time required to implement them as well as the cost and tax efficiency of each structure.
- 6.3 Following these discussions and legal advice the ACCESS group considered three options as a potential legal structure for pooling and these were:
1. Collective Investment Vehicle (CIV) either built (e.g. London CIV) or rented through a host such as Capita.
 2. Unregulated Joint Committee Structure
 3. Regulated Investment Management Company (RIMCO)
- 6.4 Option 1, the CIV model is an FCA compliant structure that has been used by the London CIV to implement their investment management structure. Option 2 is not considered to be FCA compliant and from dialogue with DCLG and HMT officials it was made clear that they would not consider an unregulated body for the pooling of assets.
- 6.5 The CIV model, option 1, which the London CIV has implemented, has at the heart of its structure an operator. The operator is responsible for managing the day-to-day management of the authorised fund; the authorised fund will hold the pooled assets of the ACCESS funds. The operator is held responsible by the regulator, the FCA, and must comply with a set of rules designed to make the operation of the authorised fund fair and the manager accountable.
- 6.6 The attached structure, appendix B, shows, in the model operated by the London CIV, how the operator works within the governance structure and how local investment strategy decisions are implemented through the operator. An investment advisory committee made up of pension fund officers provide advice and guidance on local investment strategy mandates and a joint members committee defines local Fund requirements and agree recommendations, such as required asset classes, for the operator. The Chairman of Pension Committees represent their funds on this joint members committee.
- 6.7 Option 3 is an innovative structure that contains a regulated investment management company (RIMCO) that would act as an agent for the Funds in negotiating with investment managers. This model would not pool assets and each individual fund would contract separately with each individual investment manager. The RIMCO is subject to FCA regulation and is an easier model to implement and at a reduced cost; however, Option 3 would require greater functionality partly to mitigate the risk of an unauthorised Collective Investment Structure (CIS) and avoid FCA sanction. The CIV model, option1, is the

preferred model of DCLG & HMT for the pooling of assets as it's an established structure which meets the regulatory requirements of the FCA.

- 6.8 Whilst ACCESS Pension Committee Chairs at their meeting on the 22nd April had a preference for option 3, RIMCO, as their preferred operator model subsequent legal opinion received by officers advised that despite putting a number of mitigations in place to ensure FCA compliance the RIMCO structure would not be workable for any length of time. Given this legal opinion that option 3 would not be compliant, the ACCESS Pension Committee Chairs concluded and decided at their meeting on the 23rd May that option 1, a collective investment vehicle, was now the only viable option that could be recommended to their respective pension committees. Table 2 below outlines the features of the Collective investment vehicle:

Table 2: Features of the Collective Investment Vehicle

	Collective Investment Vehicle (CIV) (based on a build model)
Set up cost	£3-4m
Ongoing cost	£2-3m per annum
Time to implement	Up to three years based on London CIV model
Regulatory compliance	Regulated by the FCA able to make investment decisions on behalf of investors (Funds) so will engage with investment managers based on the strategies outlined by all funds?
Regulatory capital	Currently assessed as up to Euros 10m. Further work to be developed on this
Asset Transition	All assets will need their beneficial ownership transferred to the CIV.
Tax efficiency	An ACS is the most tax efficient pooled vehicle for most asset types.

- 6.9 There are a number of issues which still need to be resolved in relation to the governance model:
- How the governance model is structured to work with the operator
 - Whether to rent or build an Operating Vehicle
 - How the regulatory capital will be financed.
- 6.10 In terms of the overall governance model there needs to be a clear line of democratic accountability between the individual funds and the pool. The London CIV model provides this through both officer advisors and the joint member committee from each of the funds which have decision making powers. This would also provide the structure to enable all funds to hold the pool to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- 6.11 The Operator in the Collective Investment vehicle can be rented or built. A rented model is easier to implement as the rented operator will provide the

resources, will already be FCA regulated and staffed by individuals in controlled roles who pass the 'fit and proper person' requirements of the regulator. Building your own CIV will take a longer period of time; up to 3 years based on the London CIV. It also needs to be registered with the FCA as well as staffed by individuals who can undertake the roles and pass the requirements of the FCA in that they are competent, capable, honest and financially sound. There is also the cost of setup to consider but over the longer term, the build model is more cost effective and directly owned by the ACCESS funds as shareholders. A decision on the detail of the CIV – to rent from an experienced host or to build, will be made by the ACCESS Chairs at their meeting on 27th June following further evidence gathering by ACCESS officers. Key to this will be cost, capacity and the availability of market expertise in the context of the requirement to establish any model by April 2018.

6.12 ACCESS officers are working with legal advisors to determine how the regulatory capital will be funded as this potentially is a cost that might need to be met by each of the participating eleven authorities. On an individual basis this would be a cost of around £700k to each Fund.

7. Criteria C: Reduced cost and value for money

7.1 As part of the July submission the ACCESS pool is required to provide the following:

- fully transparent assessment of investment costs and fees as at 31 March 2013 and on the same basis for 2015;
- a detailed estimate of savings over the next 15 years;
- estimate of implementation costs including transition costs as assets are migrated to the pool;
- explanation of how these costs will be met;
- a proposal for reporting transparently against forecast transition costs and savings; and
- How fees and net performance will be reported.

7.2 In order to address this particular criteria the ACCESS pool has engaged a benchmarking firm to enable us to complete this on a consistent basis and the results are due at the end of May. A summary of the results for the Hertfordshire Fund will be tabled as an addendum at this meeting.

7.3 The trickier aspect of this submission is forecasting savings and implementation costs. Hymans will provide assumptions to enable the pool to forecast savings and these assumptions will be derived from the Project Pool report that was submitted to Government in January this year. ACCESS officers have met specialist transition managers in the City who have agreed to help the ACCESS pool in providing forecast implementation costs for its pool submission. Again there will be a number of caveats around these forecast costs and they are likely to be expressed as a percentage or bps¹ of Assets under Management (AUM) and not in monetary terms.

¹ Bp –basis point = 0.01%

7.4 For the transparent reporting of transition costs and savings it's proposed that ACCESS use an organisation such as CEM Benchmarking to provide this information on an annual basis. Again the rationale behind this is that all data would be submitted on a common basis and would facilitate reporting at both a pool and fund level.

8. Criteria D: Capacity to invest in infrastructure

8.1 For the July submission the Government has asked pools and individuals funds to state how much of their current funds are invested either directly through funds or through "fund of funds". It has also asked the pools to state how they might develop the capacity and capability to assess infrastructure projects and reduce costs by subsequent investments directly through the pools. Finally, they have asked pools and funds to state their intention of how much of their fund they intend to invest in infrastructure and the ambition going forward.

8.2 The Hertfordshire Fund has a small allocation to infrastructure of US\$6.4m through its mandate with LGT Partners and this is in the US in refined products and natural gas pipelines.

8.3 Pools including the ACCESS pool have been working together at national level to develop their approach to infrastructure investment. This has involved meetings with infrastructure managers to get a better understanding of the market and how such investments could be made.

8.4 The following set of principles for infrastructure investment has been proposed by the pools:-

- ensure that any collaborative investment in this area is made in the financial interests of the members of the Funds, with no undue outside influence either at a local or national level;
- leverage the combined buying power of the LGPS;
- share and expand the internal expertise currently available within individual Pools to the benefit of all;
- accept that to be effective we should play to our strengths and look to build collaborative strategic partnerships with the wider infrastructure investment management industry; and
- Make the asset class accessible to all Funds within each pool regardless of scale.

Use the combine LGPS scale and expertise to improve governance rights and reduce the fee burden.

.8.5 The final part of the infrastructure criteria requires funds and the pool to state their intention on how much of the Fund they intend to invest in infrastructure.

There is a clear expectation that the pools and Funds set out their ambitions with regards to future investment. At a fund level a suggested approach is that the Fund will have an initial ambition to increase its infrastructure investment to an allocation commensurate with similar LGPS sized funds with that ambition to be reviewed further once the fund has met that asset allocation.

- 8.6 In conclusion given the deadline for submission it will only be possible to outline the principles on which this arrangement would work but with a clear commitment to work together to develop a collaborative infrastructure framework that offers opportunities through the utilisation of combined scale, to build capability and capacity in order to offer Funds (through their Pools) the ability to access infrastructure opportunities appropriate to their risk appetite and return requirements more efficiently and effectively

9 Next steps

- 9.1 Representatives from the ACCESS pool, including a Hertfordshire officer, will attend a panel session on the 9th June with the Government to review the progress of the work to meet the July submission deadline. The panel will be made up of officials from DCLG, HMT, Cabinet office and GAD (Government Actuary Department) as well as industry experts appointed by HMT.
- 9.2 As the draft ACCESS pool submission will not be ready until the 14th June and not reviewed by ACCESS Chairs until its meeting on 27th June it's proposed that this Committee meets again in early July to review and agree the final draft document before submission to Government,
- 9.3 Government officials will assess all pool submissions during the summer and early autumn and may request pools to submit further evidence in support of their respective proposals. Once the Government has agreed in principle the ACCESS proposal subject to any subsequent amendments, officers of the ACCESS pool will work towards setting up the investment Management Company and associated infrastructure such as auditors, tax specialists and legal advice and seek FCA approval. It's expected that the structure will be in place by April 2018.

10 Financial Implications

- 10.1 The estimated range of costs for Hymans investment consulting support and project management are in the range of £174k to £250k to support the ACCESS July submission and any additional work thereafter to September, these costs will be shared equally across the 11 ACCESS members so for Hertfordshire will be in the range of £16k to £23k. The costs attributable to ACCESS will be charged to the Pension Fund.

The initial estimate of these costs was £60k for the pool; however, these costs were dependent on the amount of work that could be delivered by ACCESS officers and additional support and advice has been required in the form of project management, specialist investment and legal advice. Legal advice commissioned by ACCESS has been done jointly with other pools to minimise cost, at the time of writing the Hertfordshire contribution to legal costs is not yet available.

10.2 City institutions such as infrastructure specialists, investment banks, custodians and transition managers have provided support, advice and facilities to the ACCESS group free of charge and these meetings and dialogue have been invaluable and essential in the development of the ACCESS submission.

Background Information

<https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>

<https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>