Foreword

Good governance is a key a building block in any successful organisation. Getting it right allows the organisation to concentrate on the things that add value.

For the LGPS, protecting members' benefits and keeping the cost to taxpayers and employers to a minimum are key objectives. A strong governance structure will ensure that asset allocation decisions are made effectively and the best fund managers are selected.

The creation of the new investment pools presents both a challenge and an opportunity. It will allow administering authorities to concentrate on effective strategic asset allocation while the pools focus on fund manager selection. Good communication will be key as employers and administering authorities will need to feel that they continue to influence decision making – it is after all they who will meet the cost of bad decisions.

I welcome this guidance as a key piece of the LGPS jigsaw. I am grateful to Aon Hewitt for the hard work they have put into it.

Mike Ellsmore
Chair of the CIPFA Pensions Panel

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Introduction

CIPFA has produced this guidance to support Local Government Pension Scheme (LGPS) administering authorities in England and Wales in demonstrating best practice governance during the implementation of, and when participating in, LGPS asset pooling arrangements, more commonly referred to as investment pooling arrangements.

There are 90 administering authorities which maintain and manage the LGPS pension funds in England and Wales. Although these pension funds continue to be separately managed and maintained by each administering authority, the administering authorities are now expected to pool investments to deliver reduced costs (through economies of scale), while maintaining overall investment performance and delivering the wider benefit of sharing best practice. Effectively, this means the appointment (and monitoring and deselection) of fund managers will be delivered through an investment pool operator on behalf of a number of co-operating administering authorities, while those administering authorities continue to have responsibility for determining their individual investment strategies including asset allocation.

There are a number of criteria determined by the Department for Communities and Local Government (DCLG) which administering authorities were asked to evidence as part of their proposals for establishing their investment pooling arrangements, and which remain fundamental to the ongoing operation of the investment pooling arrangements. These are reproduced below.

Headline criteria extracted from *Local Government Pension Scheme: Investment Reform Criteria and Guidance* (DCLG, November 2015)

A. Asset pool(s) that achieve the benefits of scale

The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. [At least one of the pooling arrangements has subsequently been granted special dispensation not to meet the £25bn criterion.] The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported.

B. Strong governance and decision making

The proposed governance structure for the pools should:

i. at the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;

ii. at the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability.

C. Reduced costs and excellent value for money

In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while maintaining overall investment performance.

Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long-term time period, rather than solely focusing on short-term performance comparisons.

D. An improved capacity and capability to invest in infrastructure

Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class.

At the time of writing, there are eight investment pooling arrangements proposed into which the DCLG expects administering authorities to be transferring liquid assets from April 2018. Accordingly the structures and governance of these investment pooling arrangements will need to be implemented before this date. These arrangements will have a fundamental impact on how LGPS pension fund investments are managed, including who makes decisions; and how these are actioned and monitored. Although much of this responsibility will move to the investment pool operator, it is critical that administering authorities continue to operate strong governance arrangements, and a key part of this will be the transformation to how they monitor the investment pooling arrangements.

This guidance highlights some key elements that will need to be considered by administering authorities. It should be considered in addition to any supporting guidance issued by the DCLG.

This guidance does not consider the establishment or operations of the investment pool operator, including where administering authorities establish their own management company to operate investment pooling arrangements and are therefore shareholders in such an arrangement. This clearly involves a number of complex legal issues, and appropriate governance arrangements will be needed. Separate legal advice should be taken in relation to what structures, processes and procedures need to be put in place to manage this.