Submission to the Department for Communities and Local Government from the Wales Pool

February 2016

Our commitment to asset pooling

The proposed pooling arrangement within Wales ("the Wales Pool") will comprise the following funds:-

- Cardiff and Vale of Glamorgan Pension Fund
- City and County of Swansea Pension Fund
- Clwyd Pension Fund
- Dyfed Pension Fund
- Greater Gwent Pension Fund
- Gwynedd Pension Fund
- Powys Pension Fund
- Rhondda Cynon Taff Pension Fund

Collaboration across the eight LGPS pension funds in Wales is not new. Opportunities for improved efficiency have been pursued for a number of years within the areas of administration and communications – for example, through the production of the All Wales Annual Benefit Statement.

More recently, there has been strong support from elected members across all eight funds to explore the opportunities for achieving efficiencies within the areas of funding and investment by considering issues such as scheme mergers and collaboration on investments. In fact, the Welsh Funds have already developed and agreed a detailed business plan which includes joint procurement of passive management and establishment of a pooling vehicle which will be up and running early in 2017 significantly ahead of the government's timetable to transfer liquid assets to a pool by 2018.

We have enclosed in the appendices letters of support from the Chairs of each of the respective Pensions Committees for the current asset pooling proposals.

In the next section, we have set out the substantial work which has taken place in recent years. The clear desire within Wales is to continue the direction of travel we have adopted to date which we believe accords with Central Government expectations whilst recognising the physical geography and economic and political context within Wales.

Progress to date

With the universal support from all eight Pension Committees, the Society of Welsh Treasurers (Pensions Sub Group) commissioned a report from Price Waterhouse Coopers (published in October 2010) on whether there was a case for closer collaboration or even merger across functions or funds to support the longer term affordability and sustainability of the Welsh Funds.

Following the final publication of the Hutton Review and consultation on the new LGPS scheme, the Pensions Sub Group published a substantial report ('Welsh Local Government Pension Funds: Working Together') in March 2013, which included a formal consultation process.

The report cited evidence that there were potentially significant financial benefits of scale to be found from working collectively through a common investment approach. The potential benefits for the funds were not directly related purely to the aggregate size of assets but rather the result of economies of scale that, together with size, allow improved governance and the potential for increased return through a combination of attributes that larger funds tend to have such as:

- More internal / specialist resources;
- More internal / hands on management;
- Better diversification – asset classes, managers;
- More bargaining power on fees;
- Better, more responsive governance structures and processes in place enabling speedy decision making.

In 2014, the results of the wider DCLG Consultation on Cost savings and Efficiency were awaited for some guidance or clarity on how best to proceed.

In 2015, the Pensions Sub Group commissioned a further report on the development of a detailed business plan for the establishment of a common investment fund. The recommendations from this report have been fully endorsed and agreed by all eight Welsh funds and **are now being implemented by the Pensions Sub Group,** namely:-

- To pursue a collaborative approach to achieve reduced costs, enhanced governance and operational management across funds.
- To select a single provider of passive global equities.
- To establish a pooling framework to extend collaboration beyond passive management.
- To adopt a regulated pooled vehicle based on the infrastructure of a third party provider.

Formal decisions were taken in September 2015 across the respective Pensions Committees to:-

- Begin a procurement process for a single passive management provider. This exercise is well advanced and it is anticipated that a provider will have been appointed by March 2016.
- Appoint an external advisor to advise the funds on procuring a provider of an appropriate collective investment vehicle (CIV). An advisor is now in place and it is anticipated that a CIV will be available for use in early 2017.

In parallel to these developments during 2015, the Wales Audit Office initiated at the request of Welsh Government a value for money review of the Welsh LGPS, under the auspices of the Welsh Government's Workforce Partnership Council. There was wide consultation of relevant stakeholders. The report concluded that there was a strong case for the Welsh Government and the Welsh Local Government Association to support the establishment of a CIV for all eight funds in Wales.

The extent of the detailed work which has already been undertaken in Wales and the widespread support which it has received is evidenced by the reports which have been included as appendices to this submission.

There is a clear intent and momentum in developing a Welsh solution capable of achieving efficiency and cost savings in respect of pension investments. The funds are committed to continuing to implement pooling arrangements which build on the substantial work which has been done to date and which will also satisfy the criteria issued most recently by DCLG. The work done to date should allow implementation ahead of the Government's intended timetable.

Characteristics of the Welsh funds

The group believes strongly that there is a balance to be struck between ensuring strong effective governance and the level of assets within the pool. A structure which can demonstrate strong cohesive governance will produce more tangible cost and performance benefits - and more quickly - than an arrangement which might have more assets but where there is less cohesion amongst participants and therefore weaker governance.

Effective governance will be assured by the common characteristics shared by the current participants.

- The administering authorities already have substantial experience of collaborating on other areas of policy across Wales.
- All participating funds have been involved in discussions on collaboration from the outset.
- No single fund dominates the pool in terms of asset size. Funds range in size between £0.5bn and £2.2bn, with an average fund size of £1.5bn.
- All funds are required to conform to policies on the use of the Welsh language in terms of their proceedings and communications.
- There are similarities in investment approach across funds – in terms of the asset classes used and investment managers employed. (More detail is provided in the Appendix.)
- All funds use an external manager model (no internal management functions).
- The funds are reasonably close geographically which will be helpful for joint working and governance.
- The funds are subject to a different audit regime than funds in England.
- There are 22 different unitary authorities across the eight funds which are subject to a different funding regime than in England.
- There is full engagement with and of elected members.

Establishing a Welsh pool for Welsh LGPS funds is the only way to deliver pooling arrangements that meet government objectives in terms of cost savings and collective governance and, at the same time, meet the needs of LGPS stakeholders in Wales including members and employers, recognising their specific characteristics, circumstances and needs.

Meeting the criteria issued in November 2015

The Government's expectations are clearly understood in Wales and have been echoed and emphasised by the Wales Audit Office report commissioned by Welsh Government.

The group have appointed a third party advisor to assist them with developing the detailed proposal for the asset pooling arrangements for Wales and to support implementation.

The group is confident that each of the specific objectives set out below will be achieved through the Wales Pool.

Asset pools that achieve the benefits of scale

The total value of assets within the Wales Pool at March 2015 was £12.3bn.

Although this falls short of the £25bn mentioned specifically by Government, the group believes strongly that the level of savings achievable will be very similar to those from forming a larger pool, i.e. that a sufficient scale of assets has been reached in order to deliver substantial benefits of size.

It is extremely difficult to estimate potential future fee savings with any degree of confidence. However, based on data provided by investment managers to Project POOL, there is some evidence that the economies of scale on individual equity mandates, for example, cease at around £500m / £1bn. Larger asset pools will face capacity constraints within the manager universe and may be obliged to appoint a larger number of managers to cope with their larger equity pools. Their individual mandates therefore may not be larger. With an active equity pot of £5.8bn, the group is confident that it can benefit from similar economies of scale from its active equity managers which manage 47% of total assets.

In addition, 20% of total assets are managed on a passive basis. The experience of the Midlands Counties project in 2015 suggests that the economies of scale from passive management can be fully captured by a relatively small number of funds and assets coming together. A manager selection exercise for a single passive provider will be concluded shortly.

Importantly, these cost benefits will flow through to the Wales Pool more quickly due to the progress made already towards setting up a collective vehicle and the strong cohesion between funds which have already been working together on pooling their investments for some time.

Due to the significant amount of work which has already been carried out by the group, it is proposed that a collective vehicle will be available for use and to receive assets by early 2017, comfortably ahead of the Government's proposed timetable.

Transfers in of listed assets – bonds and equities – could be achieved in H1 2017. The group have yet to decide on the specific arrangements for more illiquid assets such as property, private equity and infrastructure. Project POOL showed that there are potentially dis-economies of scale on some asset types such as property and private equity. The group would also welcome the opportunity to invest in national pools for those asset classes, such as infrastructure, where regional pools may not deliver the greatest level of savings.

The funds propose pooling all of their assets. The group will aim to offer an appropriate range of sub-funds within the pool to allow individual administering authorities to maintain flexibility over their detailed asset allocation.

Strong governance and decision-making

The group have already commissioned a detailed study on the potential approaches to implementation and it is their intention to appoint a provider who will make available a Collective Investment Vehicle (CIV). It is expected that 'renting' a CIV from an existing provider will allow for speedier implementation and be more cost effective given the size of the pool.

A Governance Committee will be formed to make decisions such as manager selection at pool level and liaise with the regulated operator of the CIV. The Committee will comprise an elected member from each of the eight funds and fund officers would also attend meetings of the Committee.

The number of funds participating in the pool (eight) will allow true engagement in investment decision-making by all participants. All eight funds have been participating in discussions on collaboration for a number of years already.

Reduced costs and excellent value for money

Analysis of the potential for cost savings on a fund-by-fund basis has yet to be carried out. This will be provided in our July submission.

Some of the funds are currently engaged with CEM Benchmarking and consideration is being given to using that firm to monitor the level of cost savings achieved by the group in future years.

As discussed above, it is not possible to estimate fee savings with any degree of confidence as few investment managers provide even indicative fee scales for much larger mandates. However, at this stage, based purely on the broad assumptions underlying the Project POOL methodology, aggregate savings for the pool in the region of £15-20m p.a. could ultimately be achieved once all asset classes have been moved fully into a pooled arrangement.

The group recognise that transition costs will be a significant feature of implementing new arrangements. It is anticipated that all current mandates will be moved into the pool initially with any restructuring then taking place over a period of time in order to manage costs and the level of disruption. The group will also seek to liaise with other asset pools in order to reduce transaction costs as far as possible.

An improved capacity and capability to invest in infrastructure

The group recognises that infrastructure can potentially represent an attractive investment for local government pension funds.

The current allocation across the funds in aggregate is less than 0.5% of total assets (£40m), though some funds have commitments in place which will increase that level of investment.

With the increased scale of assets within the pool, it should be possible to consider investing directly into infrastructure funds and obtain a diversified portfolio without making use of a 'fund-of-funds' arrangement. As a result, the pool is likely to provide a lower cost way of accessing the asset class - which may therefore make it more attractive from a risk/return perspective. This could lead to individual funds considering a higher allocation to the asset class than at present.

The group would also welcome the opportunity to use a national infrastructure pool within which investment management costs might be even lower and which is designed to give access to investment in projects that meet the risk / return needs of LGPS investors.

Next steps

The Welsh Treasurers have in place a professional, external project management team which is starting work on a detailed implementation plan to support our proposals for the July deadline and manage the short term implementation steps which include:

1) Completing the joint procurement of passive management to deliver quick win savings for all of the funds that will participate in the Wales Pool;

2) Following through the plans agreed to procure a third party operator to provide a pooling vehicle and make this operational to allow transfer of liquid assets to the pool by H1 2017.

Appendices

The following information has also been included.

- Asset breakdown of participating funds
- Copy of 'Welsh Local Government Pension Funds: Working Together' – Interim Report (March 2013) – published by the Pensions Sub Group
- Copy of 'All Wales Collaboration' (May 2015) – published by Mercer
- Copy of 'Review of the Local Government Pension Scheme Funds in Wales: Costs, Structure and Management' (May 2015) – published by the Wales Audit Office
- Letters of support from Committee Chairs from each of the eight participating funds.

Asset breakdown

Fund	AUM (£m)	
Cardiff	1,549	12.6%
Carmanthenshire	1,771	14.5%
Flintshire	1,339	10.9%
Gwynedd	1,396	11.4%
Powys	481	3.9%
RCT	2,228	18.2%
Swansea	1,395	11.4%
Torfaen	2,095	17.1%
Total	**12,252**	**100.0%**

Asset Class	AUM (£m)	Allocation
Active UK equity	1,336	10.9%
Active global equity	4,230	34.5%
Active emerging market equity	236	1.9%
Active equity	**5,802**	47.4%
Passive UK equity	1,079	8.8%
Passive overseas equity	732	6.0%
Passive emerging market equity	136	1.1%
Fundamental indexation	87	0.7%
Passive equity	**2,034**	16.6%
Active UK corporate bonds	467	3.8%
Active gilts	171	1.4%
Active fixed income composite	511	4.2%
Active overseas bonds	125	1.0%
Active emerging market debt	23	0.2%
Absolute return bonds	512	4.2%
Private debt	10	0.1%
LDI	298	2.4%
Active fixed income	**2,117**	17.3%
Passive UK corporate bonds	8	0.1%
Passive gilts	63	0.5%
Passive index-linked gilts	270	2.2%
Passive overseas bonds	16	0.1%
Passive fixed income	**358**	2.9%
Diversified growth fund	284	2.3%
Property	929	7.6%
Private equity	339	2.8%
Hedge fund	136	1.1%
Infrastructure	40	0.3%
Timberland/agricultural	25	0.2%
Special opportunities	10	0.1%
Alternatives	**1,762**	14.4%
Cash	179	1.5%
Cash	**179**	1.5%
Total	**12,252**	**100.0%**

Degree of manager concentration

Five managers	**52% of total assets**
Ten managers	**70% of total assets**
Fifteen managers	**81% of total assets**

This level of concentration is likely to increase once the single passive manager has been appointed and funded.