

LGPS Central Joint Committee Meeting Friday 29th June 2018

Product Development and Asset Transition Plan

Joint Report from the Practitioners' Advisory Forum (PAF)
and LGPS Central Ltd (LGPSC or the Company)

Purpose of the Report

To update the Joint Committee on the formulation of an up-to-date Product Development and Asset Transition Plan for the LGPS Central Pool (the Pool).

Background

An asset transition plan was developed as part of the original business case for the LGPS Central Pool included in the submission to government in July 2016 and was incorporated in the Regulatory Business Plan submitted to the FCA in July 2017. A slightly refined version of this initial plan also formed part of the recent Spring Progress Report to MHCLG with a note that it was subject to review. The plan was agreed by the eight Partner Funds and was based on a number of key underlying principles which remain valid today:

- delivery of the objectives set by government for scale, improving governance, reducing investment management costs, increasing the capital and capability to invest in infrastructure
- delivery of projected cost savings both at individual fund level and pool level, forecast in total to exceed £250m over 16 years
- early targeting of sub-funds with the potential to generate the highest level of cost savings and maximum Partner Fund participation
- minimum prospective assets under management of £250m per sub-fund;
- early targeting of sub-funds which meet the strategic objectives of a number of Partner Funds
- a timetable which ensures that each of the nine participating Central Pension Funds achieve a level of cost savings as soon as possible

The Partner Funds also took into consideration resource implications when formulating the initial transition plan. Given the planned transfer of staff into LGPSC from the internally managed Partner Funds to support the launch of the business, it was acknowledged that the Company would need to offer fund management options for a large part of the internally managed assets as a priority. These options were expected to include discretionary, advisory and execution only services in addition to sub-fund launches.

It was recognised that the ability of the Company to deliver the initial transition plan would be dependent on the successful recruitment of suitably experienced staff, the development of appropriate pooling vehicles and, ultimately, the commitment of Partner Funds to investing assets in the products on offer; noting that changes to Partner Funds' asset allocations would need to be accommodated.



The Company received the required regulatory authorisation to manage investments from the FCA in January 2018, with the Company's pooling vehicle for liquid assets, the Authorised Contractual Scheme (ACS), receiving FCA approval in February 2018.

The governance framework within the Company is now well established and the recruitment of the senior team is complete. With the transfer of Partner Fund staff into the business and further external recruitment, the Company has now built up significant in-house resource and has successfully recruited five out of the six planned Investment Directors together with the Responsible Investment Officer.

Three internally managed Passive Equity Sub-Funds were launched by LGPSC in April 2018 (UK Equity, Global Equity Ex-UK & Global Equity Dividend Growth); West Midlands Pension Fund is currently the sole investor in these ACS sub-funds.

The development of externally managed Global and Emerging Markets Active Equity Sub-Funds is well under way in anticipation of planned sub-fund launches later this year which will widen out Partner Fund participation in the Company's sub-funds.

The Company has also entered into a discretionary investment management agreement with Derbyshire covering UK Equities and advisory, execution with advice and execution only agreements with West Midlands covering a range of asset classes.

Current Investment Mandates

ACS Sub-Funds

UK Passive Equity Fund (Internal)

Global Ex-UK Passive Equity Fund (Internal)

Global Equity Dividend Growth Factor Fund (Internal)

Discretionary

UK Equity Active (Internal)

Advisory

Fixed Income: G10 and Index Linked

Fixed Income: Multi Asset Credit

Fixed Income: Emerging Market Debt

Target Return

Execution with Advice

Global Active Equities

Private Equity

Infrastructure

Property

Execution Only

Derivatives: Futures and FX Management

Mandates Currently Under Development/Discussion

ACS Sub-Funds

Global Equity Active (External)

Global Emerging Market Equity Active (External)

Advisory

Japan, Pacific and Emerging Market Equities

Product Development and Asset Transition Plan

It is now appropriate to formulate a combined Product Development and Asset Transition Plan taking into consideration:

- further clarity on the government's pooling objectives
- the current investment strategies (including target asset allocations) and current assets under management of the Central Pension Funds
- updated assumptions on potential cost savings
- the stage of development and capacity of LGPS Central Ltd
- progress on the development of potential pooling structures for the illiquid assets (e.g. Private Equity and Infrastructure)

LGPS's Investment Directors have been working with the Partner Funds to understand: the reasons why the Pension Funds invest in particular asset classes; the desired outcomes; and related performance targets. Updated priorities have also been discussed and it is recognised by all concerned that it is essential for resource to be focused on the development of the right offer to ensure a successful transition of assets into LGPS products whilst ensuring that the products offered provide value for money.

Representatives of the Partner Funds and the Company are also actively involved in discussions at a cross pool level, and with the wider investment management and pension fund industry to develop ideas for partnership/collaborative working to enhance the potential for delivering cost savings and added value to the Pension Funds. The development of appropriate pooling vehicles for illiquid assets, the process of embedding responsible investment into product development and options for the transition of assets into pooling vehicles are all examples of matters currently being discussed on a cross pool basis.

Following discussions with the Partner Funds, LGPS intends to present individual Business Cases to PAF for approval which will include for each product/service:

- evidence of Partner Fund demand
- a delivery plan, including the consideration of partnership/collaborative working
- a clear explanation of development and ongoing costs to enable Partner Funds to make value for money assessments and make comparisons with other similar products in the market
- an assessment of the transition implications and costs
- an assessment of the expected impact on both the overall level of cost savings and the level of individual Pension Fund cost savings

The new Product Development and Asset Transition Plan will be developed jointly by the Partner Funds and the Company based on asset class discussions to date and will evolve as individual Business Cases are considered. In order to assist with long term planning for all parties, potential products/services will be included in the plan “subject to approval” while Business Cases are being developed.

Current Priorities

Based on discussions so far, the joint development priorities for the remainder of 2018/19 are likely to focus on sub-fund launches for:

- Global Equity Active External (*A verbal update on the external manager procurement process will be given to Committee*)
- Emerging Markets Equity Active External
- Corporate Bonds Active External
- UK Equity Active Internal

A review of the demand for an internally managed Global Equity Active product is also planned, together with the development of an internally managed Factor Based investment product that would meet growing Partner Fund interest in the use of factors to enhance passive investment returns. At the same time, the Company will be investigating the optimum vehicle for pooled Private Equity & Infrastructure investment offers.

The Pool’s Responsible Investment Policy will be taken into consideration in the development of all investment mandates and the demand for more explicit Responsible Investment strategies will be investigated.

The Product Development and Asset Transition Plan will be shared with Pension Committees in the coming months to assist Funds with their planning for the implementation of investment strategies.

In the meantime, the Company continues to offer all Partner Funds the option of support on existing portfolios through discretionary management, advisory, execution with advice and execution only service agreements.

Recommendation

It is recommended that the report on the formulation of an updated Product Development and Asset Transition Plan be noted.