

DERBYSHIRE COUNTY COUNCIL

Pensions and Investments Committee

14th June 2017

Report of the Director of Legal Services

LGPS CENTRAL LIMITED

1. Purpose of the Report

To seek Committee approval to delegate authority to the Director of Finance and ICT to make decisions, in consultation with the Chairman of the Pensions and Investment Committee, on any matter which requires a decision by the shareholders of LGPS Central Limited.

2. Information and Analysis

At its meeting on 8th February 2017, the Council approved the recommendations set out in a report concerning the operational and governance arrangements for the Derbyshire Pension Fund following the amendment of the Local Government Pension Scheme Investment Regulations. A copy of the report is attached as an Appendix.

The Council agreed to becoming a joint shareholder of LGPS Central Limited, a private company limited by shares, held solely by the participating funds on a “one fund, one vote” basis; incorporated for investment management purposes and regulated under the Financial Services and Markets Act 2000, and appointed the Chairman of the Pensions and Investment Committee to represent the Council on the Shareholder Forum.

As the previous report explained, the Shareholder Forum will operate under company law and will have formal decision-making powers. The Derbyshire Pension Fund will have equal voting rights alongside the other participating funds and unanimous decisions will be required on certain reserved matters before the actions can be implemented, which will be specified in the Company’s Shareholders Agreement and Articles of Association.

These include, in the main, appointing and removing Directors, the admission of new joiners, approving strategic plans, approving accounts and audits and decisions on borrowing/lending powers. Other matters not directly related to the control of the company but to manage its operation are subject to a majority approval (75%) and these include payments of dividends and entering into lease agreements/ a capital expenditure.

Section 101 of the Local Government Act 1972 provides that the functions of a local authority can only be delegated to a committee, sub-committee or an officer of a council. It will therefore be necessary for a decision to be made on behalf of Derbyshire County Council in advance of any Shareholder Forum meeting and for the Chairman of the Pensions and Investment Committee to vote in accordance with that decision at the Shareholder Forum meeting.

Wherever possible, any matter regarding LGPS Central Limited which requires a shareholder decision will be brought to the Pensions and Investment Committee for consideration. For example, in order to meet the strict timetable for submission of the application for registration to the Financial Conduct Authority, it is necessary for the Shareholder Forum to make a decision at its meeting on 19th June 2017 to approve the Company's Regulatory Business Plan which forms part of the Shareholder Agreement and a report about the Plan is on the agenda for this meeting. However, there may be occasions in the future where it is not possible to call a meeting of the Pensions and Investments Committee before a decision has to be made as to how the Chairman of the Committee should vote at a Shareholder Forum meeting. It is for that reason that it is proposed that the decision-making should be delegated to the Director of Finance and ICT following consultation with the Chairman of the Committee. The Chairman will then vote in accordance with that decision at the Shareholder Forum meeting.

3. Financial Considerations

As set out in the previous report to Council attached as an Appendix.

4. Legal Considerations

Section 101 (1)(a) of the Local Government Act 1972 permits a local authority to arrange for any of its functions to be discharged by a committee, sub-committee or an officer of the authority.

Case law has established that the legislation does not authorise the delegation of functions to a single member. However, it is permissible to arrange for decisions to be taken by an officer in consultation with an elected member, for example the chairman of a committee.

5. Other Considerations

In preparing this report the relevance of the following factors has been considered: prevention of crime and disorder, human resources, equality and diversity, environmental, social value, health, transport and property considerations.

6. Officers' Recommendation

That the Committee delegates authority to the Director of Finance and ICT to make decisions, in consultation with the Chairman of the Pensions and Investment Committee, on any matter which requires a decision by the shareholders of LGPS Central Limited.

John McElvaney
Director of Legal Services

DERBYSHIRE COUNTY COUNCIL**COUNCIL****8 February 2017****Joint Report of the Director of Legal Services
and the Director of Finance****LOCAL GOVERNMENT PENSION SCHEME ASSET POOLING****1. Purpose of the Report**

To seek Council approval to changes required to the operational and governance arrangements for the Derbyshire Pension Fund following the recent amendment of the Local Government Pension Scheme Investment Regulations.

2. Information and Analysis**Background**

The Pensions and Investments Committee of the County Council considered a report at its meeting on 14 December 2016 regarding the changes that will be required to the operational and governance arrangements for the Derbyshire Pension Fund following the recent amendment of The Local Government Pension Scheme Investment Regulations requiring Local Government Pensions Scheme Asset Pooling and the recommendations to be made to this meeting of Council.

The Local Government Pension Scheme (LGPS) is one of the largest funded pension schemes in the world with combined assets of around £200billion. These are managed by 89 local administering authorities who historically have maintained separate arrangements for the management of scheme assets, overseen by their respective Pension Fund Committees.

Between them it is estimated that administering authorities incur total investment management costs of over £700 million per year, a significant proportion of which relates to investment management fees paid to external fund managers. It should be noted that this figure is based on reported costs, the precise treatment of which varies between funds, and is likely to be an underestimation of the total costs. Funds often use the same managers offering the same or similar services but appointed under separate agreements and on different fee terms.

Funds also vary significantly in size; large funds enjoy direct access to a wide range of investment markets and products and can often negotiate more competitive fees whilst smaller funds have more restricted options due to lower levels of investable resources and expertise and have less negotiating power in the market.

Over the past 2½ years the Government has explored a number of options for improving the efficiency and sustainability of the LGPS and has undertaken extensive consultation on the potential to deliver savings through greater investment management collaboration. A national cost benefit exercise, led by Hymans Robertson concluded that significant savings could be achieved through greater use of collective investment approaches provided that certain regulatory restrictions were removed.

Subsequently the Government announced its intention to introduce a new regulatory framework which would facilitate collective investing and issued guidance and criteria to help administering authorities to deliver the proposals for pooling aimed at reducing costs and improving efficiencies. Initial proposals for pooling were required by February 2016, followed by more detailed business case submissions in July 2016 with a target implementation date of 1 April 2018. The Government also announced that “backstop” powers would be introduced to allow the Secretary of State to intervene where authorities failed to bring forward sufficiently ambitious proposals in accordance with the guidance and criteria issued.

Over the last 12 months, the Pensions and Investments Committee and the Local Pensions Board have been kept informed of the work of the Fund in meeting Government’s criteria. Legal workshops have been organised with representatives from all the Administering Authorities, together with presentations and reports presented to the Committee outlining the proposed governance structure, business case and associated implications as submitted to Government in July 2016. The Chair and Vice-Chair of the Committee and the Director of Finance have attended regular joint meetings including a number of Stakeholder days.

LGPS Central

Following the Government’s announcement and discussions with a number of potential pools it was determined that a pool based around a Midlands grouping would be the most beneficial for the Derbyshire Pension Fund. This resulted in a joint proposal from Cheshire West and Chester, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands and Worcestershire pension funds to create “LGPS Central” (“the Pool”) with combined assets of £35 billion.

Following confirmation from the Minister for Local Government that this proposal was acceptable, a joint working group of officers drawn from the 8 authorities, supported by external advisers, developed a detailed business case setting out how LGPS Central would meet the 4 key assessment criteria laid down by the Government;

Criteria 1 – Asset pools that achieve the benefits of scale (greater than £25 billion).

Criteria 2 – Strong governance and decision making.

Criteria 3 – Reduced costs and value for money.

Criteria 4 – Improved capacity and capability to invest in infrastructure.

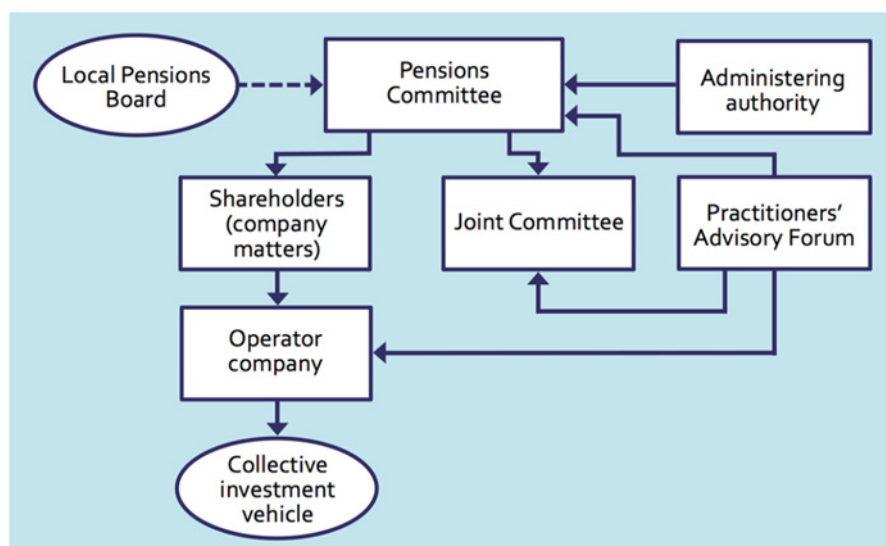
In readiness for meeting the Government's timetable of April 2018, LGPS Central Ltd has been incorporated as a company registered with Companies House. To assist in its creation, and in agreement with all the Administering Authorities, Wolverhampton City Council established the company as the subscriber shareholder with a sole Director. The other 7 Authorities will subscribe to the company following finalisation of adoption of the various legal agreements.

Governance Structure

Detailed reports have been presented to the Pensions and Investments Committee in the last year explaining the key elements of the business case and seeking approval for the proposed governance, oversight and management structure of the pool.

The following diagram outlines the Governance structure.

Summary of Governance Structure



The structure will allow participating funds to exercise control, both individually and collectively, over the new arrangements, not only as investors in the pooled fund but also as shareholders of the operator company. A summary of the LGPS Central governance structure prepared by the company's legal advisers, Eversheds LLP is attached as Appendix 1.

The Government has also made clear their expectation that pooled entities must be registered with the Financial Conduct Authority (FCA) and regulated under the Financial Services and Market Act 2000 to ensure appropriate

safeguards over the management of client money. As such the new LGPS Central company will be subject to ongoing oversight by the Regulator, and key management positions, including the company directors, will need to be “approved persons” able to demonstrate appropriate knowledge, expertise and track record in investment management. They will also carry significant legal personal liability for their actions and decisions.

The relative merits of buying or renting an established operator to manage the day to day running of the pool were carefully considered against the benefits of setting up a jointly owned company with associated shareholder rights. The constituent Funds unanimously agreed that the latter option, whilst more expensive in the short term, offers significant advantages in terms of greater flexibility and control and this is the basis upon which the business case has been developed.

Whilst assets will be managed on a pooled basis, each Fund will be able to exercise their investor rights independently although clearly benefits of scale will be most effectively harnessed where parties work together in a co-ordinated way to align their decision making. An important example being Responsible Investment Policy e.g. social, environmental and governance policies and policies on the exercise of voting rights where cross voting between funds within the same pool would be both costly to administer and counter-productive.

The degree of control to be exercised by the shareholders through their reserve powers will be greater than is generally the case ensuring the company is a publicly owned company over which the local authorities have direct control. This is to satisfy the exemption criteria in regulation 12 of the Public Contracts Regulations 2015 (Teckal) and thereby avoid the need for a full procurement exercise to procure the services of the company.

A Shareholder Forum, operating under company law, will have formal decision making powers. The Derbyshire Pension Fund will have equal voting rights alongside the other participating funds and unanimous decisions will be required on certain reserved matters before the actions can be implemented, which will be specified in the company’s Shareholders Agreement and Articles of Association. These include, in the main, appointing and removing Directors, the admission of new joiners, approving strategic plans, approving accounts and audits and decisions on borrowing/lending powers. Other matters not directly related to the control of the company but to manage its operation are subject to a majority approval (75%) and these include payments of dividends and entering into lease agreements/capital expenditure.

A Joint Committee set up in accordance with provisions of the Local Government Act 1972, will be the forum for dealing with common investor issues and for collective monitoring of the performance of the pool against the objectives set out in the LGPS Central business case submission. It will however have no formal decision making powers and recommendations will

require the approval of individual authorities in accordance with their local constitutional arrangements.

To support the Joint Committee in its role, a Practitioner Advisory Forum (PAF) will be created consisting of officers from each of the individual Funds. The PAF will support Joint Committee meetings and action any recommendations, including the reporting back to Fund Pension Committees of matters requiring their attention.

In order to avoid potential conflicts of interest and to maintain clarity over the governance arrangements it is recommended that the Council nominates different representatives to the Joint Committee and the Shareholder Forum.

TUPE / Location

It is expected that staff who are currently employed by partner funds in the Pool to manage their investments or perform other related activities will transfer under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) to the new company subject to detailed consideration of current and future roles. This applies to staff currently employed by the Derbyshire and West Midlands Pension Funds as they are the only 2 funds in the pool which currently have significant in-house investment teams. Nottinghamshire has a small in-house capability although it is considered unlikely that these staff would transfer to the Pool.

It has been agreed that LGPS Central Ltd will be based at 2 locations. The headquarters will be based in Wolverhampton with a satellite office in Matlock.

Government Approval

The detailed business case was reviewed by a joint DCLG/HMT Review Panel in early September 2016. Representatives of the Pool met with the Minister for Local Government on 15 November 2016 to discuss the submission, and following the discussion received a letter of confirmation from the Minister that he is content for LGPS Central to proceed as set out in the final submitted proposal.

Impact on the role of the Pensions and Investment Committee

Article 12 of the Council's Constitution which relates to the Pensions & Investments Committee is attached at Appendix 2, with a proposed amendment to Article 12.3 iv and a new Article 14 to reflect the Committee's post-pooling responsibilities.

For the most part, the role of the Committee will be unaffected by the implementation of pooling and the creating of LGPS Central. The Committee will continue to be responsible for monitoring the overall management, performance and administration of the fund and for setting investment

strategy, including the overall allocation of assets which is the critical factor in determining investment performance.

Importantly, the Committee will also continue to be responsible for communicating with individual scheme members whose benefits are guaranteed by law and are therefore not affected by the new pooling arrangements or investment performance.

Responsibility for the direct investment management through an in-house team and appointing external investment managers and overseeing their performance, including any decision to dismiss, will transfer to the Pool as will tactical decisions on the implementation of the overall investment strategy and the choice of specific investment vehicles.

Recommendations being made to the Council

All 8 Funds are seeking approval, in accordance with the terms of their own Constitutions, to recommendations similar to the recommendations in this report.

3. Financial Considerations

The estimated costs of setting up LGPS Central is around £4 million. This will be shared equally between the participating funds with Derbyshire's share being around £500,000. There will also be significant transition costs as existing investment mandates are unwound and funds transferred into new collective investment vehicles. It is not possible to accurately predict these costs but the business case includes an estimate of £50 million. Transition costs will also be shared between the 8 funds on an equitable basis.

In addition, as the new company will be a regulated entity under FCA rules it will need to hold regulatory capital to guarantee its solvency. The regulatory capital requirement is expected to be in the region of £8 million (£1 million per fund).

Derbyshire's share of all costs (including the regulatory capital) will be met from the Pension Fund and there will therefore be no direct impact on the Council's revenue or capital budgets. This is currently being reviewed in the context of tax implications by Price Waterhouse Cooper, one of the external advisers to the pool.

Estimated net total savings for LGPS Central as included in the July submission to Government, are in the region of £182 million over the period from 2018/19 – 2032/33, with annual savings of around £29 million being achieved by the end of this period. Comparative figures for the Derbyshire Pension Fund are £47 million and £4 million respectively.

4. Legal Considerations

Changes to the Local Government Pension Scheme Investment Regulations came into effect in November 2016 requiring all administering authorities to commit to an investment pooling arrangement which meets the criteria and guidance laid down by the Secretary of State in November 2015. Where authorities fail to comply with the criteria and guidance, the Secretary of State has powers to intervene and to issue a Direction requiring changes to investment strategies and investment management arrangements, or the transfer of the investment functions of an administering authority, either to himself or a nominated party.

The key risks are:-

- failure to achieve the statutory implementation deadline of 1st April 2018
- failure to manage costs and savings in line with the agreed business case
- failure to meet the requirements of the FCA regulator
- failure to recruit appropriately skilled and experienced senior personnel to the new company

Comprehensive programme governance arrangements are in place to ensure that the statutory deadline for the implementation of pooling is achieved and that costs and savings are managed in accordance with the agreed business case. The S151 officers of each of the participating funds sit on the LGPS Central Programme Board and regular joint meetings are held between the Chairs and Vice-Chairs of the respective Pension Fund Committees to ensure effective member oversight of progress and delivery.

Expert advisers have been appointed to provide support to LGPS Central on legal matters, FCA registration, taxation and overall programme management, and professional recruitment consultants are being appointed to assist and advise on executive recruitment and remuneration.

Browne Jacobson LLP were appointed jointly by the Funds to assist them with reviewing and approving the documents required to establish the joint pension fund investment pool which so far have included the Shareholders Agreement, Articles of Association for LGPS Central Ltd and the Inter-Authority Agreement, which have been agreed by the Director of Legal Services.

5. HR Considerations

As contained in the report.

6. Other Considerations

In preparing this report the relevance of the following factors has been considered: prevention of crime and disorder, equality and diversity, environmental, social value, health and transport and property considerations.

7. OFFICERS' RECOMMENDATIONS That Council approves the following:-

- 7.1 To enter into an Inter-Authority Agreement between Cheshire West and Chester Council, Derbyshire County Council, Leicestershire County Council, Nottinghamshire County Council, Shropshire Council, Staffordshire County Council, Wolverhampton City Council and Worcestershire County Council to establish a joint pension fund investment pool, in accordance with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016; to be overseen by a Joint Committee established under s102 of the Local Government Act 1972.
- 7.2 To become a joint shareholder of LGPS Central Limited, a private company, limited by shares, held solely by the participating funds, on a 'one fund, one vote' basis; incorporated for investment management purposes and regulated under the Financial Services and Markets Act 2000.
- 7.3 To appoint the Chair and Vice-Chair of the Pensions and Investments Committee to represent the Council on the Shareholder Forum and the Joint Committee respectively.
- 7.4 To appoint the Director of Finance or his nominee to represent the Council on a Practitioner Advisory Forum, providing joint officer support to the Joint Committee and Shareholder Forum.
- 7.5 To authorise the Director of Legal Services to enter into all necessary legal agreements to establish a joint asset pool and investment management company.
- 7.6 To approve the amendments to the terms of reference for Pensions and Investments Committee in Article 12 of the Council's Constitution as set out in Appendix 2 to this report to take effect from 1 April 2018.

John McElvaney
Director of Legal Services

Peter Handford
Director of Finance