

Letter emailed to:
LGPSReform@communities.gsi.gov.uk

Phone: (01772) 538102

Email:

Your ref:

Our ref: LCPF/GG/WN

Date: 18 February 2016

Dear Sirs

**LOCAL GOVERNMENT PENSION SCHEME:
INVESTMENT REFORM CRITERIA AND GUIDANCE (ISSUED 25 NOVEMBER
2015) – RESPONSE FOR 19TH FEBRUARY, 2016**

In the recently released Government document, 'Local Government Pension Scheme: Investment Reform Criteria and Guidance', LGPS funds have been asked to make an initial submission indicating our commitment to pooling and a description of our progress towards formalising our arrangements with other authorities.

The following provides an overview of the pooling arrangement already agreed between Lancashire County Pension Fund (LCPF) and London Pensions Fund Authority (LPFA) – both Funds have been working to further pooling within LGPS and we welcome Government's proposals. We also summarise the pooling discussions we have had with other LGPS funds since Government issued its document, together with our respective involvement in, and commitment to, infrastructure investment.

We address the following areas:

- Background to the existing pooling arrangement between LCPF and LPFA
- Discussions with other LGPS funds to date
- Participation in direct infrastructure investment to date
- What we have learned so far.

George Graham – Director

Lancashire County Pension Fund

2nd Floor • Winckley House • Cross Street • Preston • PR1 3LT

Background to the Existing Pooling Arrangement between LCPF and LPFA

To summarise our current pooling arrangement:

Both LCPF and LPFA have been working to further the agenda of LGPS reform since the Government issued its original consultation on these matters. We are now working towards launching our Asset Liability Management (ALM) partnership this April, which will bring together around £11 billion worth of assets. This organisation will be named the Local Pensions Partnership Ltd¹ ('the ALM Partnership'). We welcome Government's ambition to achieve pooling within the sector, but recognise the ALM Partnership will be required to expand its pool to achieve Government's target criteria.

The structure we are putting in place reflects the best practice that has emerged in the discussions that have occurred within the sector since the Government's announcement last November. Specifically, there will be an Authorised Contractual Scheme (ACS) managed by an FCA registered operator, with strong oversight from participating pension funds. We expect to have FCA approval for our ACS by end March 2016. Subject to this date being met, the intention is for LPFA and LCPF to start pooling all assets from April 2016.

The ALM Partnership's structure has been designed from the outset to:

- Enable other funds to participate in the pool;
- Preserve funds' local accountability and enable them to keep control of strategic decisions (e.g. employer contribution rates, strategic asset allocation and setting risk appetite);
- Maintain the sovereignty of all pension fund partners; and,
- Accommodate illiquid assets (e.g. infrastructure, property and other alternatives) held outside the ACS but within the pool via Special Purpose Vehicles, giving funds the opportunity to benefit from a joint management approach to these assets.

The ALM Partnership covers the full range of activities involved in the running of pension funds, presenting opportunities to achieve a wider range of economies of scale. Specifically, the ALM approach allows us to address both sides of the balance sheet, i.e. both asset and liability management.

¹ The ALM Partnership was initiated in 2015 under the working name of Lancashire & London Pensions Partnership Ltd (LLPP Ltd).

On the asset management side, the experience of just our two funds collaborating thus far will result in a conservative estimate of investment management fee savings of c. £30m over the next five years, and, our increased scale is forecast to achieve enhanced investment outcomes of around £20m-£30m from their current levels, again on a conservative basis. **Given our commitment to wider pooling (see details of additional pooling discussions below), we fully anticipate further cost savings to emerge from the detailed analysis which will take place between now and July.**

On the **liability management** side, we are investing to build on existing in-house liability management expertise to develop processes and tools to:

- Support stability and, where feasible, consistent improvement in triennial funding levels together with reduction of (funding level) volatility to enable stable or improving employer contributions.
- Demonstrate an asset mix that delivers stable lower primary contributions, and investment returns in line with actuarial forecasts on a consistent basis.

An improved understanding of our pension fund liabilities and closer engagement with fund employers, which is a key component of our ALM approach, will enable us to plan cash flows more effectively and determine the returns required from our assets more accurately. **These are tools and expertise that we will contribute to the resources and capabilities being considered within our wider pooling discussions.**

To date, LCPF and LPFA have jointly invested approximately £1.5m in start-up costs to provide the foundations for a pool and have been working together to progress the initiative for around 18 months. This represents a significant investment of time and resource by both funds into the development of the ALM Partnership. The scale of commitment required to get this type of arrangement off the ground is not to be underestimated, and we have been happy to share our learning with colleagues from other funds even when they are seeking to create alternative pools.

Pooling Discussions with other LGPS Funds to Date

Since Government released its document last November, the ALM Partnership has held a number of pooling discussions with groupings and individual funds. To summarise:

Greater Manchester Pension Fund (GMPF), Merseyside Pension Fund (MPF) and West Yorkshire Pensions Fund (WYPF). These funds have total assets of c£35bn. We have exchanged letters of intent and are in discussion with these funds around how to best work together using the very significant in-house expertise of all the participants. Given the timescale, discussions are at an early stage, but the next

steps between now and July are for all participants to develop a proposal around how the pooling arrangement will work and meet Government's criteria. All parties anticipate the discussions reaching a successful conclusion.

Discussions with Other Funds. We have had early discussions with a number of other funds, either about wider pooling via the ALM Partnership, or specifically about direct investment in Infrastructure. In particular, the Royal County of Berkshire Pension Fund, which has indicated in a paper to their Pension Fund Committee that the ALM Partnership pool will be their preferred route for pooling purposes – we hope to include Berkshire in the wider pooling discussions referenced above. We do not anticipate any of these discussions being concluded before 19th February.

Participation in Direct Infrastructure Investment to date

Both LCPF and LPFA have an established track record of investing in Infrastructure and it will remain an important asset class for pooled investment (see some highlights below). We are actively pursuing transactions in the UK and Europe, which we are aiming to involve other LGPS funds in as co-investors. **Existing infrastructure assets of both Funds will transfer to the pool as appropriate.**

The combined pool of talent within the ALM Partnership will enable us to build a sustainable team experienced in the ongoing management of direct infrastructure investments, as well as the initial acquisition. This team has already built relationships with advisers that enable us to create and operate cost-effective and focused bid teams able to meet the tight deadlines involved in infrastructure transactions. Participation in overseas transactions has also allowed the team to develop relationships with significant overseas pension funds that potentially will allow the ALM Partnership (and any wider pool that is created) to participate in some larger deals as co-investors.

We fully support a collective LGPS approach to investing in infrastructure, which includes the formation of a joint officer group to develop detailed proposals for the creation, structure, governance and operation of a joint vehicle, for agreement by fund authorities and submission to Government in time to meet the July deadline.

Track record of investments in Infrastructure

LCPF...

- Was one of the first funds to invest directly in the infrastructure space acquiring through a limited partnership structure a portfolio of UK land fill gas energy generation assets in 2010.
- Has become an investment partner with EDF (Energie Nouvelles), securing a 50% stake in EDF's Portuguese wind assets as the first investment through this partnership.
- Has made a range of direct investments in clean energy in the UK, US and Australia.
- Has supported UK social infrastructure through initial seed investment of £180m in Heylo Housing, an organisation which supports the development and ongoing management of shared ownership housing.
- Has committed £100m of its local commercial property allocation to schemes supporting the Preston, South Ribble and Lancashire City Deal.
- Submitted a bid for the UK Government's stake in Eurostar; although this bid was unsuccessful, it gave LCPF significant experience in large-scale infrastructure tenders.
- Currently has an allocation of 10-15% of the Fund's asset value to infrastructure with the intention that 2/3 of this should be direct investment. At the time of writing approximately 7% of the fund is invested (compared to an LGPS average of 2%) and the portfolio has generated a from-inception return of 20.32% up to 31.03.15, with significantly lower than average fees due to the level of direct investment.

LPFA...

- Collaborated with Greater Manchester Pension Fund in 2014/15 to create a £500m joint infrastructure Investment Fund. The first long-term investment – a renewable asset – was announced in October 2015, with more to follow. The process has begun to make this fund available for other LGPS funds participation.
- Is providing 85% of the funding (£55m) needed to build a 200-home property development in East London, named Pontoon Dock. The development will include 137 private rented sector homes, 42 for affordable rent and 31 for shared ownership.
- Has a shareholding/board seat in Semperian PPP Investment Partners, which manages a portfolio of UK PFI/PPP assets.
- Together with the Local Government Association, LPFA recently responded to the National Infrastructure Commission's Open Consultation into the Development and Funding of the UK's Long-Term Infrastructure Needs. We set out our strong recommendation for the establishment of an LGPS body that could match national and global infrastructure opportunities with prospective investor pools and assist in attracting private investment.

What we have Learned So Far

Following on from the work we have undertaken to date to create the ALM Partnership, which will provide key infrastructure for any pool in which we are involved, we consider there are a number of elements that have contributed to success in this endeavour:

- Funds should come together on the basis of things they have in common;
- One or more strong in-house teams around which to build the operator organisation;
- A commitment to meeting the appropriate regulatory standards, so that all participants can feel comfortable that their funds are being appropriately looked after;
- A commitment both to strong oversight by participating funds and, equally,
- An understanding that the structure created is part of the LGPS landscape and is not designed to make profits, instead distributing any surplus back to participating funds.

We believe the work that the ALM Partnership has undertaken to date, and what we now anticipate working on within our wider pooling discussions, will deliver all of these.

Yours faithfully



Cllr Kevin Ellard, Chair of the Pension Fund Committee
Lancashire County Pension Fund



George Graham, Director
Lancashire County Pension Fund