

**Wales Pension Partnership
Local Government Pension Scheme Pooling:
Autumn Progress Report 2018**

Pool: Wales Pension Partnership (WPP)

Date: 8 October 2018

Criterion A: Scale

- **Scale – please state the estimated total value of assets owned by participating funds**

In our final submission to DCLG in July 2016, we stated that the ambition for the Wales Pool was to create appropriate vehicles for collective investment for all participating funds across all asset classes in time. We can confirm that remains our intention.

The total value of assets of the participating funds referred to in that proposal, valued as at March 2015, was £12.8bn. The total value of assets as at 30 June 2018 was circa **£17.5bn**.

- **Assets within the pool – please state the total value of assets included in the transition plan for investment through the pool, with the valuation date**

The passive investments of the WPP (circa **£3.3bn / 19% of WPP**) are now effectively within the pool. These are held by the WPP authorities in the form of insurance policies. We regard these assets as already forming part of the Pool. The selection exercise for a single manager was carried out on a collective basis in order to derive maximum fee savings from the scale of assets, and the monitoring of the manager and any future retender will be the responsibility of the Joint Governance Committee (JGC).

It may not be feasible for these passive investments to be transferred into the WPP ACS managed by the third party operator as the individual funds will remain beneficiaries of the relevant policies and changing from a life policy vehicle may create additional taxpayer costs without any benefit to justify the change. However, the JGC will review the position on a regular basis.

- **Assets outside the pool – please state the value of assets not included in the transition plan for investment through the pool structure, with the valuation date and the rationale for retaining these assets outside the pool structure**

The funds have a number of illiquid investments with fixed term lives. It would be very costly to exit from such investments before the planned realisation of the underlying assets. The intention is that the Operator will make available pooled vehicles to allow all future commitments to be made on a collective basis to illiquid asset classes such as private equity and infrastructure. As the current illiquid investments mature and capital is returned to investors, they will be replaced by new commitments through the new pooled vehicles. These new investments will all form part of the Pool. The JGC may also explore the potential for the Operator to carry out due diligence monitoring on the current illiquid investments until they mature.

In addition, one of the authorities has a Liability Matching mandate and a Managed Account Platform, comprising assets in total of approximately **£500m**. Although the Fund's ISS states that it is committed to investing all assets through the Pool where pooling objectives are met, for these bespoke mandates, it will depend on the capabilities of the appointed Operator to accommodate these mandates within the Pool.

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- **Transition – please state the current transition plan, including:**
 - **the sub-funds that are on offer and planned, with launch dates;**
 - **progress on establishing these sub-funds; and**
 - **timetable for transitioning assets**

Initial ACS sub-funds – Tranche 1

After passive investments (already within WPP pooling arrangements), actively managed global equities is the next largest single component across the combined asset allocation of the participating funds (circa **£3.5bn**). WPP is therefore prioritising active global equities for the initial ACS sub-funds.

A prospectus allowing the two sub-funds (Wales PP Global Growth Fund and Wales PP Global Opportunities Equity Fund) to be launched within the WPP's ACS structure was approved by the FCA in July 2018, along with approval to establish the ACS structure.

Transfers of assets into the two global equity sub-funds are expected to be carried out in late 2018.

Further phases of ACS sub-fund launches

The JGC formally approved in September 2018 the next phase of sub-funds, which will be active UK & European (ex UK) equities, with a planned launch date of early 2019. A prospectus allowing the funds to be launched will be submitted to the FCA for approval in October 2018. Initial proposals for a range of fixed income funds have also been discussed and final decisions are expected on the nature of the funds in November 2018. The launch of the fixed income funds is expected by April 2019.

£m	Launch date (past/ planned)	Expected asset value
Pooled assets		
Global Equity funds – Tranche 1	November 2018	£3.5bn.
UK & European Equity funds – Tranche 2	January 2019	£1.4bn.
Bond funds – Tranche 3	April 2019	£2.2bn.
Other assets	TBC	£7.1bn.
Total pooled assets		£14.2bn.

Assets not invested through the pool		
Passive assets – held in life funds		£3.3bn.
Total assets not invested through the pool		£3.3bn.

Total assets owned by participating funds		£17.5bn.
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With the passive investments in life funds included as discussed above, this means that circa 60% of the WPP investments should be within the pooling arrangements by April 2019.

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- **Reporting – please explain how you will publicly and transparently report progress against your transition timetable**

WPP is committed to transparent reporting, respecting normal protocols and constraints in respect of commercially sensitive information.

We will report progress in the first instance to the participating authorities' pension committees and local pension boards who in turn will report progress to their normal stakeholder audiences.

This will include appropriate progress reporting in annual reports for the individual funds and any ongoing reporting required by government or the Scheme Advisory Board.

Criterion B: Governance

- **New functions – please provide an update on the governance arrangements and their current status:**

Given the key role governance played in the Government's criteria for pooling, and the responsibility placed on the administering authorities and the democratically elected councillors on our LGPS pension committees to ensure long-term returns for the benefit of members and participating employers, the WPP has placed a strong onus on governance. The diagram below illustrates the governance structure established by the WPP.

The constituent authorities have committed to the establishment of the WPP through an Inter-Authority Agreement and following the formalisation of the JGC in June 2017, the JGC have met frequently to carry out their responsibilities.

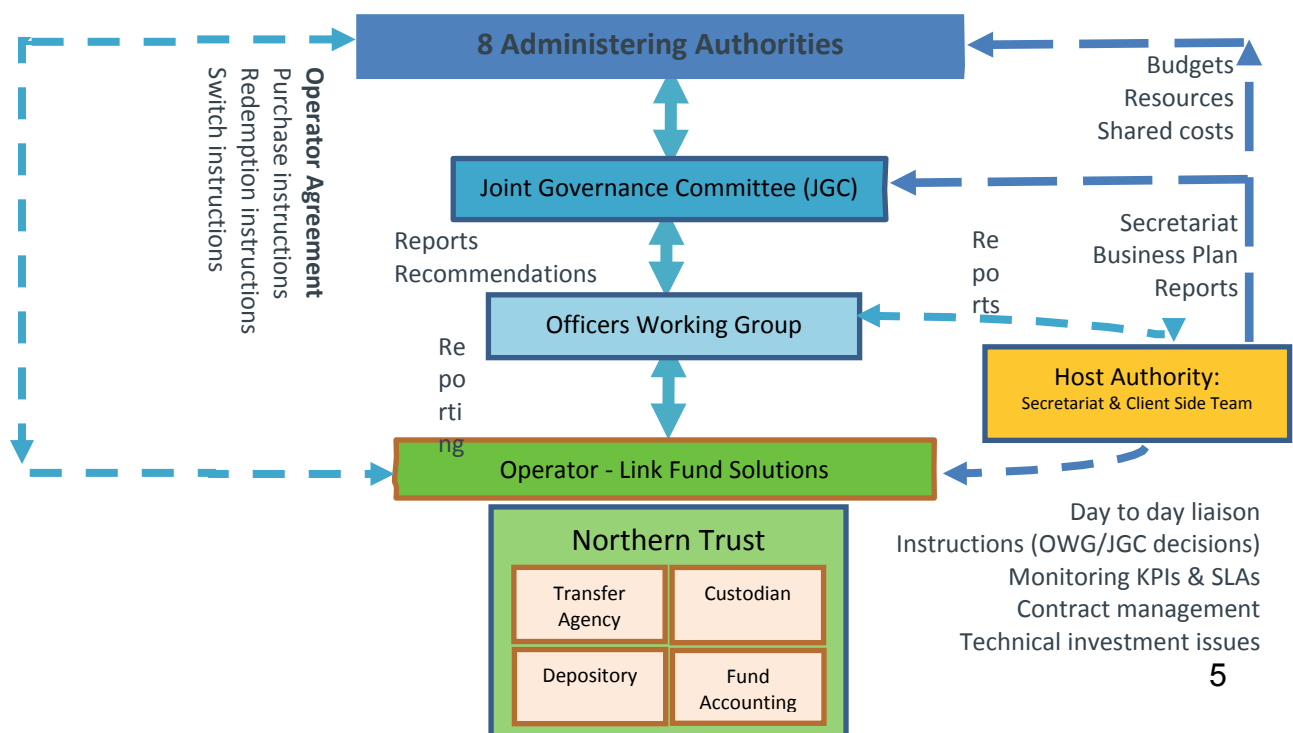
Roles and responsibilities of the Constituent Authorities, Joint Governance Committee (JGC), Host Authority and Operator are summarised in the Appendix.

Carmarthenshire took on the role of "Host Authority" with effect from June 2017.

In summary, the roles and responsibilities of the Host Authority include:

- secretariat functions for the "client side" governance bodies (JGC and Officers Working Group (OWG))
- technical support to the JGC and OWG
- managing the contract with the third party Operator - Link Fund Solutions(LFS)
- preparation of the WPP business plan
- co-ordinating reporting and
- day to day liaison with the Operator and advisors.

Following a procurement process in 2017, WPP appointed Link Fund Solutions (LFS) as the "Operator" of the Pool. The Operator Agreement with LFS was finalised and effective from December 2017.



- **Fund governance (i.e. joint committees or equivalent/related functions) – terms of reference, resources, key appointments, policies and procedures, accountability to elected members, external support/scrutiny.**

Terms of reference for client side governance groups

The terms of reference for both the Officers Working Group (OWG) and Joint Governance Committee (JGC) are incorporated into the Inter-Authority Agreement (IAA), which was signed and executed by the 8 Constituent Authorities involved in the Wales Pension Partnership in June 2017.

Accountability to elected members

The Operator is held to account by the JGC. As per the IAA, the JGC comprises one elected member from each Constituent Authority. This ensures a direct link to the elected members and pension committees with fiduciary responsibility for the governance of the individual funds participating in pool.

- **Contract management resources, appointments policies and procedures**

Resources

It has been agreed that the Host Authority will have 2 full time permanent staff initially with support from the Treasury & Pension Investments Manager as and when required. This will be reviewed on a regular basis.

In addition the Host Authority is supported by external advisors including:

- Burges Salmon – legal advisors
- Hymans Robertson – project management and technical support.

Appointment policies and procedures

Any appointments made will be done so in accordance with LGPS standard regulations.

- **Relationship – please provide an update on the relationship between the fund and the pool company, including:**

- **who makes what decisions (asset allocation, manager selection, custodian selection, etc)**

Investment Manager Selection

The Operator Agreement sets out the contractual duties of the Operator and governs the relationship between the Operator and the WPP.

The Operator is responsible for:

- appointment of investment managers (IMs)
- due diligence
- entering into investment management agreements (IMAs)
- monitoring and reporting IM performance
- dismissal and replacement of IMs

It is assisted in these functions by Russell Investments (RI). RI is a sub-contractor to the Operator (LFS) with capabilities in investment manager research. It was a requirement of the tender process that the Operator should be able to provide these services using in-house capabilities or using a sub-contractor.

Selection of custodian and other support services

The Operator is also responsible for the appointment of, and contractual relationships with, all of the necessary service providers for the establishment and operation of the pool investment vehicles including depositary and custodian services.

Asset allocation decisions

The IAA, which governs the relationship between the 8 Constituent Authorities, sets out that responsibility for decisions relating to individual asset allocation is to be retained by the Constituent Authorities.

For further details please refer to the Roles and Responsibilities Appendix.

- **Reporting and communications - to assure authorities that their investments are being managed appropriately by the pool company, in line with their stated investment strategy.**

The Operator (LFS) is contractually bound to provide

- (i) a monthly KPI report which will include details on its performance against specified delivery targets;
- (ii) regular reporting on investment performance at pool and individual fund authority level.

It is also a regulatory requirement that the Operator should monitor adherence by the IM to the investment objectives of the sub-fund it manages as set out in the sub-fund prospectus.

- **Risk management/contingency planning on both sides (e.g. how will changes in fund requirements be implemented, how will unsatisfactory performance be tackled) and key contract features (where relevant).**

The Service Level Agreement section of the Operator Agreement includes details of the required timeframes and service standards the Operator must adhere to. This includes procedures and timescales for responding to change requests including sub-fund requirements of the WPP authorities.

The Host Authority will monitor and manage the performance of the Operator on behalf of the JGC. This will include monitoring the adequacy of the Operator's resources.

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The Operator Agreement includes details of the remediation available to the WPP should the Operator fail to fulfil their obligations under the Service Level Agreement.

In the current establishment phase of the project, project managers within LFS and Hymans (acting for the Host Authority) monitor risks on the Operator and client side respectively. Appropriate mitigation plans are identified and actioned.

- **Transparency – please confirm that the pool company has signed up to the Scheme Advisory Board Code of Transparency.**

The Operator has confirmed it will sign up to the SAB code of transparency along with their key sub-contractor, Russell Investments.

- **Benchmarking – please set out how benchmarking will be used to assess governance and performance of the fund and the pool company.**

Performance of the pool company will be measured against the Service Level Agreement contained within the Operator Agreement.

Investment performance against agreed benchmarks will be monitored by the Operator.

The WPP funds are using CEM Benchmarking for investment cost benchmarking.

Criterion C: Reduced costs and value for money

CIPFA guidance on costs and savings and March 2015 baseline

Reporting in line with new CIPFA guidance and a 2015 baseline will commence in 2019 allowing for the full year 2018/19 and reflecting the final outcome of Link's fee negotiations on the sub-funds that will launch in this financial year.

Set up costs

We estimate that the costs to date in setting up the pool have been in the region of circa **£1.5m**.

This includes:

- External legal costs (including legal support on the Operator procurement)
- External project management and administration support
- External consultancy support on technical investment matters and Operator procurement
- Host authority costs to date

The stated implementation costs exclude officer time. The costs of setting up the ACS, its sub-funds and the systems and processes to run the ACS are being absorbed by the Operator.

Current running costs

All of the Operator costs are based on funds under management in the ACS and, to date, are nil. Current annual running costs for the Host Authority are circa £200k. Host Authority resources are currently supplemented by external consultants (see "Set up costs" above), but we expect regular external support to run down within the next 6-9 months.

Asset transition costs

Asset transition costs to date are nil. Link has carried out a procurement exercise to select a Transition Manager (TM) for the first sub-funds. Once the procurement is finalised, the TM will prepare an implementation plan and pre-trade estimates of the Implementation Shortfall (IS) (total asset transition costs including TM fees, buy-sell spreads, market opportunity cost, etc.).

Total annual investment costs and total expense ratio

Not available for this up-date. However, CEM have been appointed to measure and benchmark WPP costs.

Estimated cost savings to date

(i) Passive investments

Reductions in fees for **passive** management are currently delivering estimated **annual savings of circa £2.0m**.

(ii) Initial ACS sub-funds

The new sub-funds use a mixture of existing and new managers selected by Link and its investment adviser Russell Investments. Fee negotiations are conducted by Link and Russell. At the time of writing fee rates are being finalised for the initial sub-funds. Russell Investments have provided provisional estimates of net savings (fee and tax

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savings less additional costs of the ACS operator and depositary) relative to current costs for assets that will be transferred to the first 4 sub-funds. They estimate **annual savings for the first four ACS sub-funds will be in the region of £2.5m (excluding tax savings) or £5m (including tax savings).**

Estimated savings (IM fees and tax) secured to date (net of Operator costs)

	Est annual savings to date (manager fees and tax)	Est annual pooling costs in respect of these assets
Passively managed equities	£2.0m	Nil
Four initial ACS sub-funds	£5.0m*	*ACS operator/depositary fees netted off of savings
Total annual savings	£7.0m	

Points to note:

- Please see previous progress reports for estimates of long term future savings once the majority of assets are pooled.
- Costs here exclude asset transition costs which will be estimated as part of transition planning. Actual asset transition costs will also be measured post-transition.
- Operator/depositary costs will increase in £ terms as assets in the ACS grow but basis points fee rates are tiered by AUM and taper down as AUM increases.
- The extent of any savings varies between participating authorities depending on how much they pay to current Investment Managers. Some participating authorities will benefit from savings from tax recoveries that can be made in the ACS but are not available in current investment vehicles.
- It is possible that an individual authority could see a net cost increase on one or more of its ACS investments because historic fee rates with existing managers are competitive. IM fees in the ACS for managers selected by Link and Russell could be higher or savings in IM fees on moving into the ACS could be outweighed by additional ACS running costs.
- In any such cases it is important to recognise other pooling benefits including any tax savings and potential for better risk-adjusted future investment returns.
- Most of the WPP authorities do not currently stock lend but will be reviewing that policy in respect of new ACS sub-funds. Currently only one of the eight authorities in the WPP uses stock lending, but if all eight funds agree that the ACS sub-funds should stock lend, this would create additional income for the WPP investors.

Break-even year

Since the WPP opted for a “rented” Operator model (initially at least) it has not incurred the significant up-front costs of building its own Operator company. This will help reduce break even time.

It is anticipated that aggregate savings (IM fees and tax savings) across the ACS sub-funds will quickly exceed the additional costs of pooling in the ACS.

However, the payback period is not immediate due to (i) set up costs to date (see above) and, more significantly, (ii) up-front asset transition costs. (For the first wave of sub-funds Link and Russell have selected a number of the investment managers who are not

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managers currently used by WPP funds which may result in higher transition costs than would otherwise have been the case.)

The break-even point will vary between sub-funds and between the investors in those sub-funds according to the transition costs and investment fees and taxes before and after transition.

The expected break-even year will be re-assessed in light of estimated and actual transition costs on the first phase of sub-funds.

Other benefits

In addition to IM fee savings and tax savings there are other scale and pooling benefits. These include:

- 1) **Tax savings:** There are material tax savings for some authorities as a result of moving into the new tax efficient ACS vehicle. The extent of savings will vary between WPP authorities and across asset classes and will depend on the tax efficiency of the investment funds currently used by individual authorities (e.g. those currently using pooled mandates will benefit from a switch to segregated mandates in an ACS structure).
- 2) **Diversification and improved risk-adjusted returns:** Potential for improved future risk-adjusted returns (e.g. pooling enables individual funds to achieve greater diversification by manager than they might achieve on their own at the same time as getting benefits of scale on IM fees).
- 3) **Access to alternative asset classes:** Some authorities will in future be able to access certain asset classes via the pool that are less easy to access economically without pooling scale (e.g. private equity and infrastructure). The immediate priority is to transfer liquid assets to the pool ACS, but WPP will also be considering options for accessing alternative asset classes such as infrastructure.
- 4) **Stock-lending:** The move to the pool has provided the opportunity for the WPP funds to re-appraise their policy on stock lending (currently only used by one of the WPP funds). Stock-lending can deliver additional income that is material in the context of operator / depositary fees and can help offset the additional costs of pooling.

Benefits realisation plan for achieving benefits of pooling, while at least maintaining overall investment performance.

At a high level, the plan for delivering scale benefits for the WPP pool is:

- 1) In 2018, create ACS umbrella for sole use of WPP authorities – complete;
- 2) In 2018-19, create sub-funds covering major liquid asset classes:
 - a. global, UK and European equities – in progress
 - b. fixed interest – consultation on specification and requirements in progress
- 3) In 2020 onwards, identify and implement the most cost effective ways of accessing illiquid assets – either through LGPS wide investment vehicles or through bespoke arrangements for the WPP pool.

We remain on track with this plan for delivering benefits to the WPP pool.

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The WPP recognises that investment performance can have a more material impact on outcomes than cost savings. WPP is therefore focused on maintaining investment performance. As part of the design of new sub-funds Link / Russell are providing analysis of risk adjusted prospective returns their proposed new ACS sub-funds and comparing this with the current WPP investments that will transfer to the ACS. The aim is to design new ACS sub-funds with superior risk adjusted prospective returns. This is achievable in part from the greater diversification individual authorities benefit from as a result of pooling.

Link is contractually obliged to monitor investment manager performance and raise issues with investing authorities. In the event of concerns re performance in any of the sub-funds, the Operator (with its investment adviser) is expected to carry out a review of sub-fund investment managers.

In order to monitor achievement of savings and investment performance objectives:

- a) CEM Benchmarking have been appointed to provide detailed analysis and reporting on cost savings;
- b) The contract with Link requires regular reporting by Link on costs and investment manager performance.

Reporting and new CIPFA guidance

We confirm that all administering authorities will apply the new CIPFA guidance when preparing their annual reports from 2018/19 in order to publicly and transparently report:

- set up and transition costs;
- fees and net performance for each asset class, with a comparison to a passive index for each listed asset class; and
- savings and other benefits of pooling

The Operator will be required to provide WPP with all of the data on cost savings, transition costs and investment performance needed by the JGC and by individual authorities and required to comply with all relevant external reporting requirements.

Criterion D: Infrastructure

Ambition

Our stated ambition remains as set out in our original submission from 2016, namely - in the short to medium term - to have at least 5% of assets invested in infrastructure investments with a longer term aspiration set at 10% - subject to satisfactory investments being available.

Current allocation

A total of circa **£225m** is either already invested in infrastructure assets or formally committed to infrastructure funds, equivalent to circa 1.3% of pool assets, so the stated target represents a significant increase from the current position (potentially a five to ten-fold increase).

However, we also acknowledged in our original submission that allocations to infrastructure represent asset allocation decisions and are therefore the responsibility of individual funds rather than a collective decision for the Pool.

Approach to infrastructure investment

We have opened discussions with the appointed Operator and adviser as to the options available for accessing infrastructure investments through the pool. It is intended that one or more pooled vehicles will be made available for funds to make commitments to investment in the asset class. In addition, the WPP has engaged with a third party consultant on a potential infrastructure strategy. The OWG have also received a presentation on a specific local Infrastructure project.

We are also aware that the most efficient way of accessing infrastructure investment suitable for LGPS fund liabilities might be through national vehicles, e.g. GLIL, developed for use by the funds and pools. We therefore continue to engage with and work collaboratively of the cross pool infrastructure collaboration group in order to ensure that we may benefit from any national initiatives which may emerge in the future.

Appendix - Roles and Responsibilities

Constituent Authorities / Individual Funds

In addition to managing its own liabilities, setting its own employer contributions and administering its pensions:

- Investment strategy decisions
 - Strategic asset allocation
 - ISS/FSS
 - Investment beliefs
 - Delegation of investment manager decisions to the Pool
- Monitoring/reporting
 - Monitoring investment performance of own portfolio
 - Challenge pool if investment managers are underperforming
- Governance
 - Holding pool to account (e.g. if not happy with sub-fund performance, request review)
 - Providing representation on the JGC and OWG
- Operational/BAU
 - Timing of own transitions (initial and ongoing) and switches between sub-funds
 - Custody for non-pooled assets
 - Instructions to invest, redeem, switch in or between the pool sub-funds
- Policies*
 - Rebalancing policy
 - Responsible investment
 - Voting policy
 - Stock lending – what is in/out – existing/future
 - Policy/rules for investment in infrastructure
 - Currency overlay strategy

* WPP will consider the extent to which some policies or guidance should apply at pool level in order to avoid, where possible, the creation of additional sub-funds to accommodate different policies.

Joint Governance Committee Responsibilities

- Governance
 - Conform with IAA (joiners/leavers/cost allocation)
 - Hold Officer Working Group (OWG) to account
 - Oversight of all assets under pool governance (including passive investments)
 - Strategic planning, resourcing plan, business plan and budget for WPP
- Operator relationship
 - Agree specification for Operator and oversee procurement
 - Recommendation on 3rd party Operator to Constituent Authorities
 - Monitor performance of Operator
 - Recommend termination of the Operator, extension or new supplier to Constituent Authorities at end of contract
 - Input to consultation by the Operator on matters such as reviews of Investment Managers and asset transition plans
 - Agree any changes to the Operator Agreement, SLAs or agreed practices, procedures and protocols (“change control”)
- Decisions at pool level
 - Instruct Operator on initial sub-fund and mandate requirements
 - Instruct Operator to establish additional sub-Funds or terminate existing ones
 - Instruct Operator on requirement for any non-ACS pooling vehicles
 - Approve high level transition plan proposed by Operator
 - Decisions on how to access infrastructure
 - Agreeing any common policies (e.g. stock lending/voting)
 - Decide other advisors and suppliers to the WPP
- Communications e.g. government and civil servants, press, etc
- Value for money

Host Authority & Client Side Team

- Secretariat to Joint Committee
- Lead on procurement for pool services (e.g. advisers, etc.)
- Client side team for:
 - Operator contract management
 - Monitoring performance of Operator against SLAs and KPIs
 - Day to day liaison with the Operator and its provider of establishment, consultative and non-consultative services, especially on matters affecting all funds / investors in the pool
 - Liaison with other advisers
 - Reporting Operator performance to the OWG and JGC
 - Executing and reporting progress on the Business Plan agreed with the JGC and OWG
 - Other analysis, support and reports for the OWG and JGC as required.
Examples:
 - options for accessing alternatives / illiquid assets including infrastructure
 - pool policies on ESG
 - implications of regulatory change and required action e.g. MiFID
 - options at end of Operator contract – extend, re-tender, build and own
 - Client side team will NOT be middle man for all instructions to the Operator from individual administering authorities (investors and clients of the Operator) e.g. payments into the pool's investment funds, redemptions, switch instructions can all go directly to the Operator

Operator (Link Fund Solutions) Responsibilities

Core responsibilities

- Establish and operate an ACS and sub-funds for the sole use of the WPP LGPS funds
- Obtain all necessary regulatory approvals
- Fund administration
- All regulated functions and reporting
- Appoint and contract with investment managers
- Select and procure asset servicers (transfer agent/ depository/ custodian/ accounting)
- Propose sub-fund structure
- Manager monitoring and review and manager searches and recommendations (working with investment advisors)
- Asset transition management
- Implementing individual fund rebalancing policy