LGPS update

ACA Conference Gatwick

February 2016

pwc

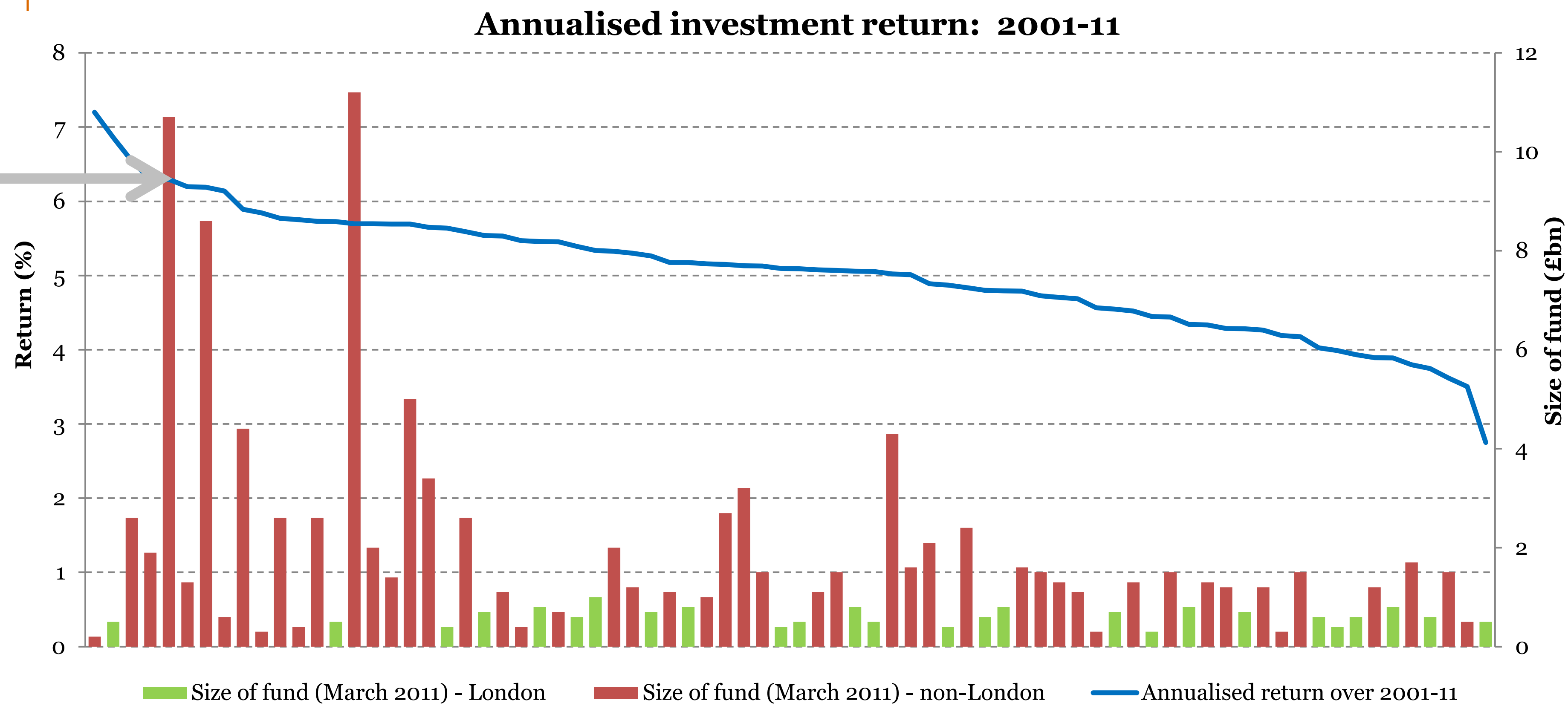
Agenda

1 Investment: LGPS asset pooling

2 Actuarial valuations 2016

3 Affordability of benefit structure - discussion

Evidence for scale – from pwc 2012 report



Greater Manchester LGPS with £10.7 billion, 6.3% pa average return. The 7 largest funds averaged 5.73% pa.

The 26 London Funds measured by CIPFA averaged 4.87% pa: some performed well; governance questions; better relative performance over other periods.

Investment

Current private sector

- Decades ago, an asset led approach was common. The equity was king.
- Allocations to growth assets now lower - typically 30% to 60%.
- Risk reduction programmes now common, reflecting employer and trustee requirements.
- Liability Driven Investment (LDI) one example of this.

Current LGPS

- Allocations to growth assets remain typically 60% to 80%.
- Consistent with being open to accrual and able to seek real returns.
- No evidence that LGPS Funds with low funding levels are taking extra risks.
- Interest in LDI varies.

Future LGPS

- Allocation between asset classes the driver of success.
- Increasing interest in infrastructure.
- LDI: which metric to stabilise?
- Opportunities to tailor investment strategies for Admitted Bodies.

Allocation between classes is more important than manager choice

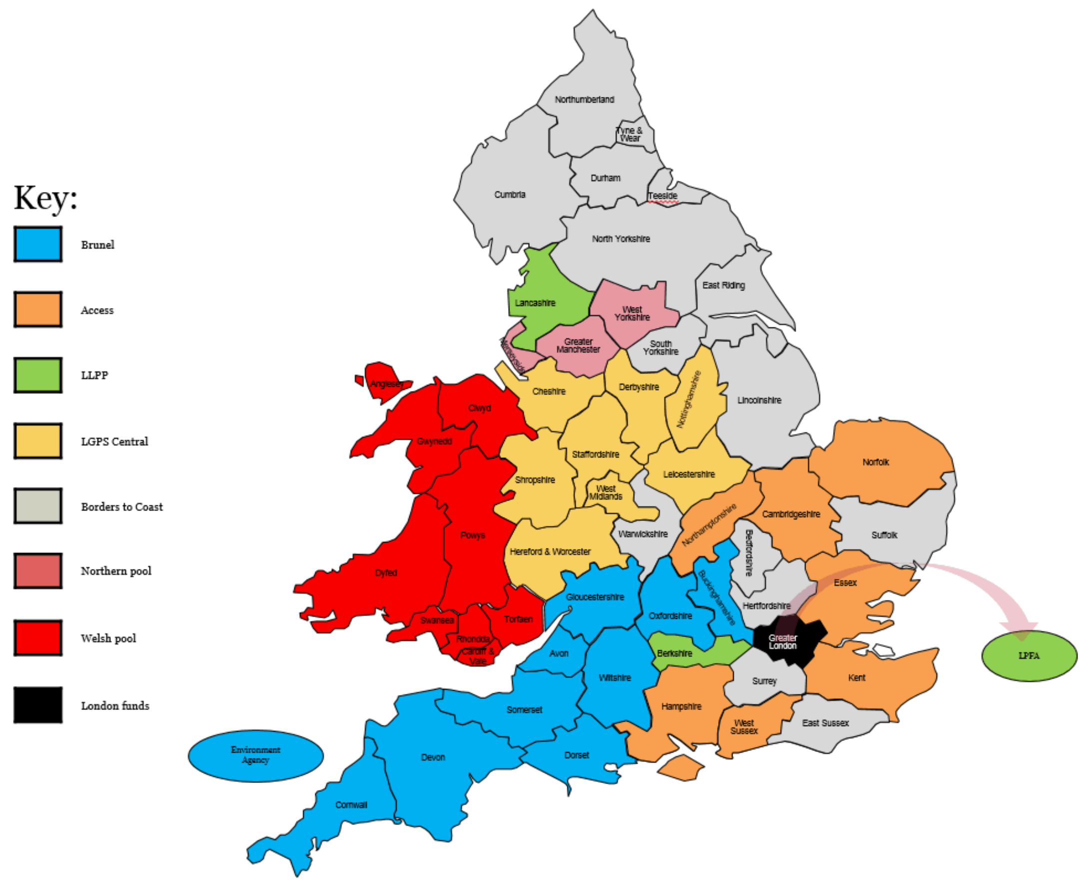
Pooling - where are we now? – one possible map as at 19 February 2016

Any map will be wrong!

Several Authorities currently deciding between two or more options.

Possibilities for further change between February and July.

Overlay of national initiatives, notably passive and infrastructure.



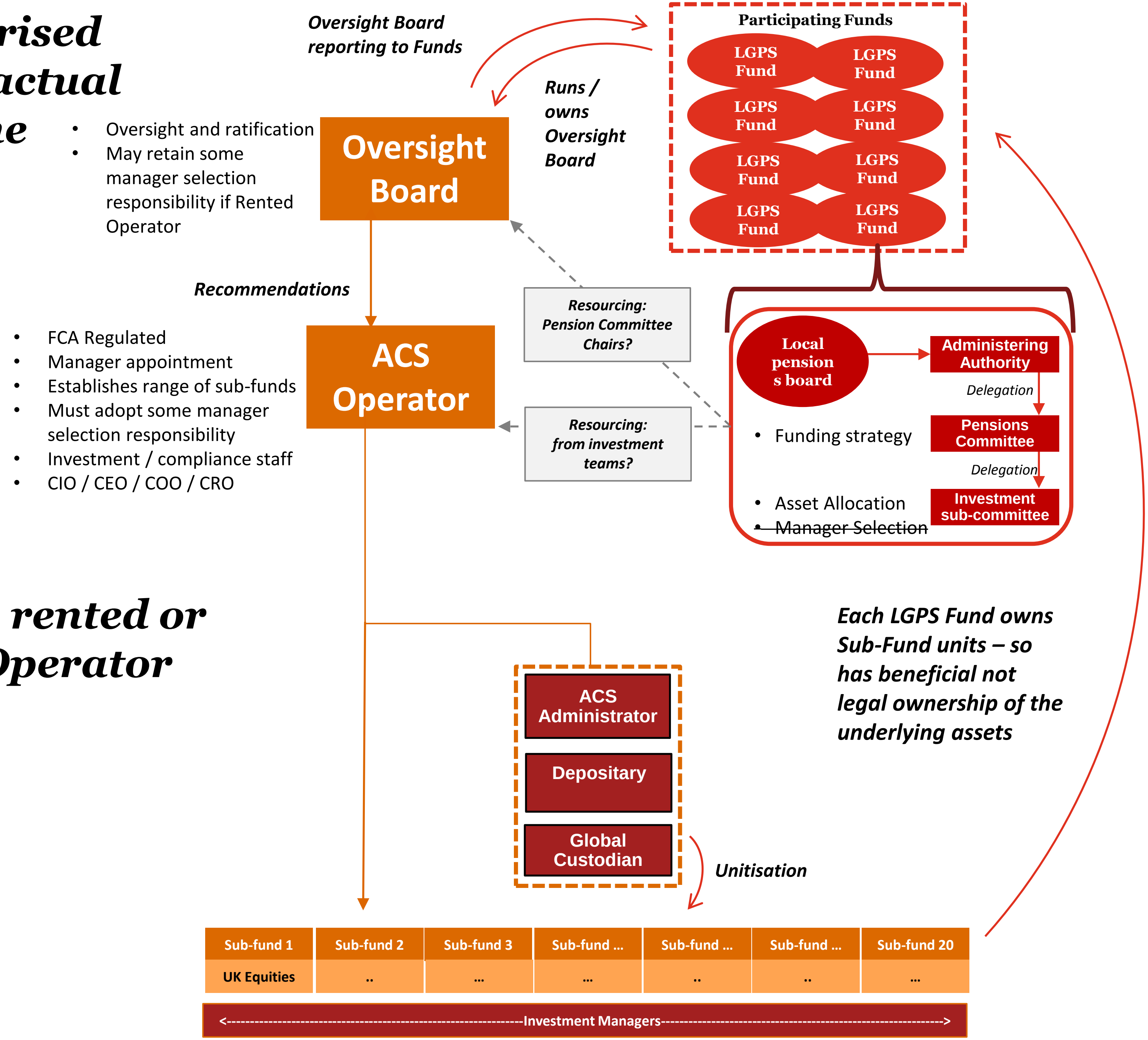
DCLG Pooling criteria

Issue	Description	Summary of requirements
A.	**Scale of assets under management**	• Size of pool once fully operational, its legal type • Assets outside of pool and rationale • Internal work and services to be hired • Timetable for establishment and asset transition
B.	**Strong governance and decision making**	• Governance structure including accountability between pool and elected members, external scrutiny • Mechanisms for Authorities to hold pool to account • Decision making at all stages of investment • Resourcing • Net performance publication, benchmark usage
C.	**Substantial cost savings**	• Estimate of 2013 and current level investment costs • Detail on cost savings over 15 years • Estimate of implementation and transition costs • Proposals for reporting against forecasts
D.	**Improved infrastructure capability**	• Existing proportion of Fund allocated • Proposals to acquire capacity and capability to assess infrastructure projects with reduced costs via pooling • Future proportion of Fund to be allocated and how derived

Strong governance and decision making - Criterion B

- *"To maximise savings, manager selection will need to be undertaken at the pool level."*
- *"Authorities should ensure that there remains a clear link through the governance structure adopted, between the pool and the pensions committee."*
- *"Pension committees should continue to set the balance between investment in bonds and equities, recognising their authority's specific liability and cash-flow forecasts. Beyond this, it will be for each pool to determine which aspects of asset allocation are undertaken by the pool and which by the administering authority."*
- *"Authorities will need to consider the additional benefits of centralising decision making to better exploit synergies with other participating authorities' allocations and further drive economies of scale."*

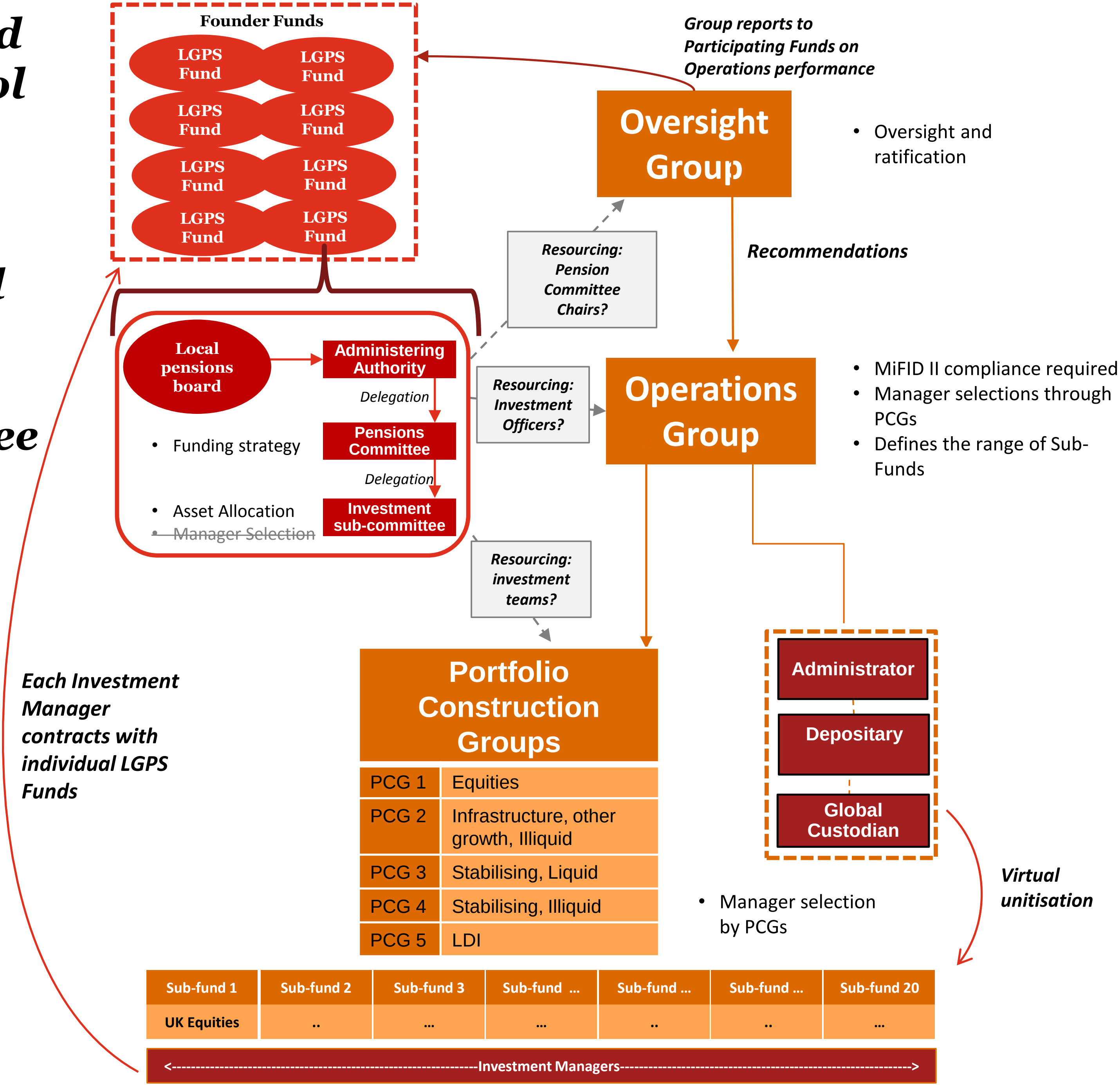
Authorised Contractual Scheme



with a rented or built Operator

Combined Asset Pool

delivered by a Joint Committee



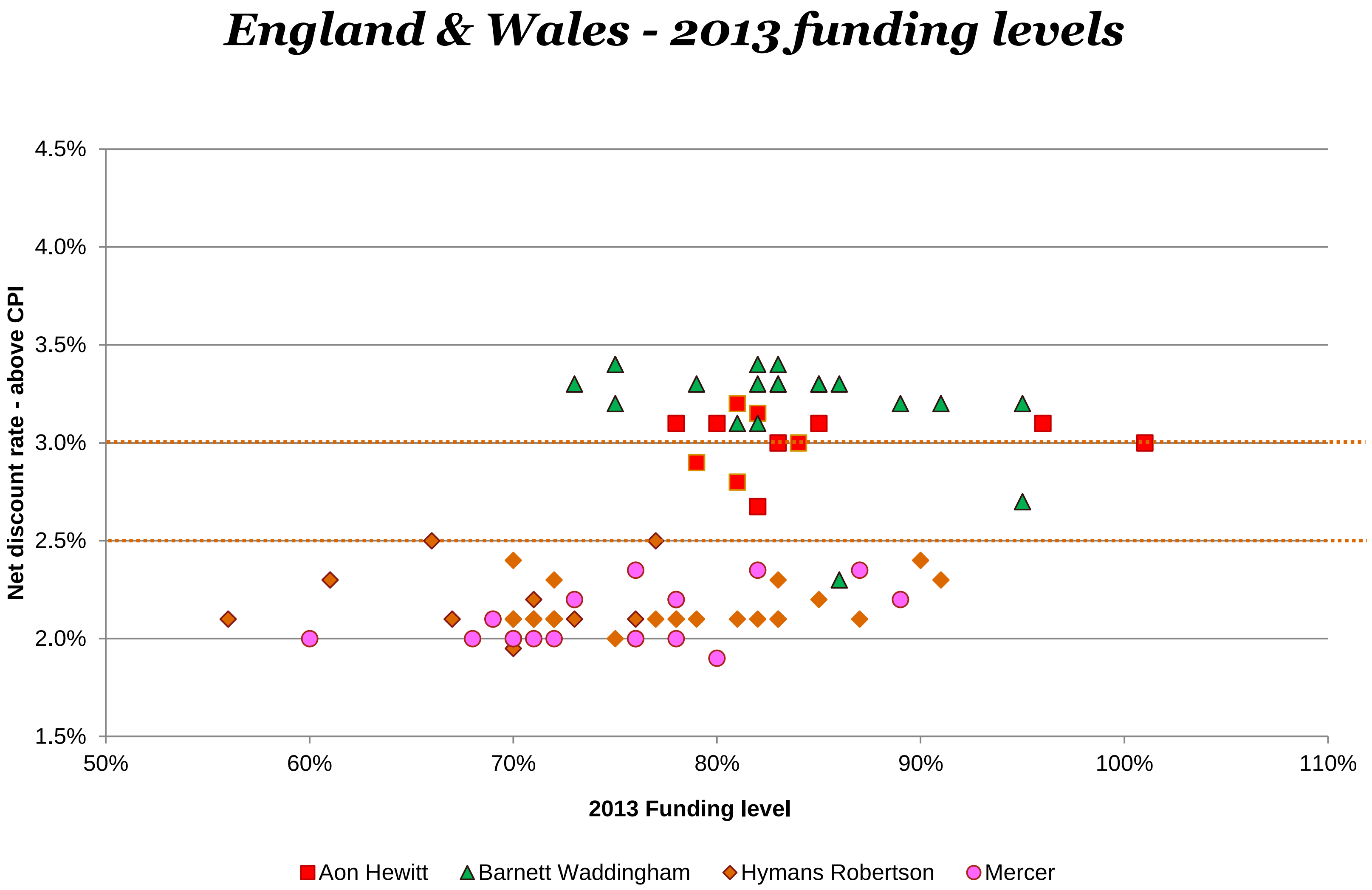
Infrastructure capability - Criterion D

- Many LGPS Funds have an existing belief in and commitment to this asset class, and these have developed quickly over last two years.

- Statistics can mislead – typically 4% strategic target allocation, 2% already committed to specific investments and 1% drawn down?

- *"Developing larger investment pools … will make it easier to develop or acquire improved capacity and capability to invest in infrastructure … it should be possible to reduce the costs associated with investment in this area…the case particularly if authorities pool their infrastructure investment nationally."*

Affordability



Cash

Current private sector

- Future service DC contribution rates are varied, many high, but more low.
- Cash therefore freed up towards meeting deficits, despite …
- … strong actuarial assumptions to measure deficits, reflecting markets and journeys to exit.
- Pensions Regulator required to consider affordability.

Current LGPS

- Different house styles, so a challenge to obtain consistent information on payments.
- "Common contribution rate" can mean a future service rate or also include deficit payments.
- Contributions have low correlation to standardised deficits.
- 20 year recovery periods still common, but reducing for Admitted Bodies

Future LGPS

- Contribution disclosures could identify cash amounts likely over next 7 years.
- Surpluses could raise questions about payments below future service rates.
- Stability requirements could be made easier to interpret.
- More flexible exit arrangements could be encouraged.

Cash is king

Covenant and governance

Current private sector

- Trustees assess employer covenant at valuations, and between: thinking like banks.
- Strength of employer covenant is key – Integrated Risk Management.
- Consider appropriate KPIs to act as triggers for action.
- Assess impact of transactions on covenant.

Future LGPS

- tPR to have responsibility for governance.
- Accountability and pressure to evidence governance.
- Balanced score card to monitor Fund health?
- Increasing recognition of the value of covenant monitoring.

Current LGPS

- Mix of public and private sector employers. Certain sectors typically present a higher risk.
- Employers liable for each other's liabilities: last man standing.
- Range of approaches to assess and monitor covenant.
- Guarantees/indemnities in respect of admitted bodies.

Regular and proportionate monitoring. Governance that is evidenced

Questions