

## **Memorandum of Understanding**

This agreement is made on 19 February 2016 between the Local Government Pension Scheme ('LGPS') funds administered by Tameside Metropolitan Borough Council, Wirral Metropolitan Borough Council, City of Bradford Metropolitan District Council ("the Funds")

The Funds will work together to form a Collective Asset Pool ("the Pool") which meets the criteria released by Government on 25 November 2015.

This Memorandum of Understanding sets out at a high-level the expected operation of the Pool and the proposed steps in its development.

This will form the basis of the joint submission to Government which the Pool is required to make by July 2016.

The proposals outlined below will likely be subject to change following receipt of professional advice and any changes to the pooling criteria or further detail being provided by Government.

In working together, knowledge and expertise will be shared and resilience will be developed. Collaboration with other LGPS pools is expected and will be encouraged.

## **Investment philosophy**

The long-term vision of the pool is to provide participating funds with access to a range of internal and external investment management and related services at low cost, to enable the participating funds to continue outperforming their benchmark.

Liabilities influence the asset structure; funds exist to meet their liabilities. Asset allocation is the dominant determinant of portfolio risk and return. Markets can be inefficient. Risk premia exist for equity, credit, duration, illiquidity, inflation and volatility. The key principles of the investment approach are a long-term perspective and to maintain simple arrangements with a relatively low number of managers and low manager and portfolio turnover.

The proportion of assets in the pool that are internally managed is expected to increase over time.

The pension committees of the participating funds will retain responsibility for liabilities, setting the strategic asset allocation of their fund and associated regulatory policies and strategy documents.

Subject to continuing to meet best practice, participating funds will also retain the ability to select asset class (equity, bonds, property etc...), territory (UK, Europe, US etc..) style and whether managed actively or passively. For an initial period, participating funds will have the discretion to determine whether a mandate is managed internally by the pool or by an external manager.

If it is expected to improve returns net of costs, as and when necessary, the pool will seek FCA Authorisation for the management of specific asset classes. This may require the establishment of legal vehicles such as an Authorised Contractual Scheme ('ACS').

## **Governance**

The proposed governance structure for the Pool is an oversight board, consisting primarily of representatives of the participating funds' pension committees, which will define key strategic objectives and provide scrutiny to an executive body of officers who will make the investment management decisions. Both the oversight board and the executive body will work closely with independent advisors.

The legal structure of the Pool Board is expected to be a joint committee.

All Pool Board members have equal voting rights.

In general, decisions of the Pool Board will be made by majority decision. Unanimous decisions will be required for any changes to governance arrangements

The Pool Board will consider whether to appoint independent members and advisors to the Board and whether these appointments should be in a voting or non-voting capacity.

The Pool Board can form sub-committees to oversee specific aspects of the Pool's operation in more detail.

### **Role of Pool Board**

The Pool Board will oversee all aspects of the operation of the Pool's Executive Body, it will not perform any FCA regulated functions. The Board will have oversight of the following:

- The implementation of participating funds' asset allocation instructions;
- The transition of existing fund investments into the Pool;
- Monitoring and benchmarking performance and reporting back to individual fund committees;
- Responsible Investment activities
- Engagement with the committees of participating funds to help drive efficiencies (for example providing details of what mandates already exist in the Pool and new mandates);
- Nominating representatives to national structures as appropriate (for example any national infrastructure board);
- Staffing requirements of the Pool.

### **Approach to infrastructure investing**

The Pool will seek to collaborate more widely across the LGPS on infrastructure investment, either by working collaboratively with other pools or as part of a LGPS-wide infrastructure vehicle. This collective working will help increase the scale and diversity of infrastructure investment held by the Pool.

To minimise cost and build on existing experience, the Pool will look to use the existing GMPF/LPFA Infrastructure Partnership ('GLIL'), which is open to other investors, for direct infrastructure investments.

Subject to suitable governance arrangements, consideration will be given to infrastructure investment in the area served by the participating funds which meet the twin objectives of generating appropriate commercial returns and supporting the local economies of the participating funds.

Where a fund holds local investments outside the Pool, management of those assets will be undertaken by the Pool where that will achieve value for money.

### **Staffing of Executive Body**

Over time a multi-site investment team will be developed, with different specialisms being based in different locations in order to make best use of the skills, talents and resources that the Pool has available to it and the desire for local expertise to be maintained.

The intention of the Pool is for a combined Pool resource to undertake monitoring and reporting to fund committees of all participating funds' investments.

Further work will be undertaken to determine whether the Pool's objectives are best delivered via a 'shared service' model, where staff will be employed directly by the administering authorities or whether an investment company should be established by the Pool.

### **Transition of assets into pool**

The Pool will start to make collective investments at the earliest practical opportunity. It is expected that initial pooled investments will be in asset classes where there is currently duplication of effort and material economies of scale can be generated.

As part of the work in formulating the submission to Government in Summer 2016, the pool will draw up a high-level timetable for how assets will transition into the Pool.

Participating funds, in collaboration with the Pool, will periodically assess whether it is cost effective, for both the Pool and the fund, for any non-pooled assets to transition into the pool.

## **Management of non-pooled assets**

Funds' existing holdings of the asset classes listed below are expected to be held outside of the pool in the medium term. The pool will work together to establish measures which could be taken in order to drive efficiencies in the management of these assets, some of these are set out below.

Infrastructure - combine monitoring resources for existing fund assets

Property – undertake a tender exercise to select a single provider for individual funds' existing advisory mandates and the newly created Pool property fund for new investments

Private equity – combine monitoring resources; develop opportunities for co-investment

Other illiquid assets – combine monitoring where possible

Where possible, external managers (for example life-wrapped passive equity) will be jointly procured between participating funds in order to leverage the Pool's scale.

Joint procurement of other investment related service providers such as custodians will also be considered.

## **Costs**

Detailed work will be undertaken on a mechanism for Pool costs to be met by participating funds on an equitable basis.

This will allow smaller funds to benefit from the economies of scale generated by the Pool and avoid an increase in 'like-for-like' costs for larger funds compared to their existing position.

## ESG

Consideration of ESG matters will be an integral part of the investment process. The pool will work collaboratively to consider ESG and Responsible Investment issues.

Regular dialogue will take place between the Pool Board and participating funds' committees on how ESG/RI issues are being tackled by the Pool.

Participating funds will have flexibility to express different views where this is appropriate to their investment principles.

The pool will collaborate with national initiatives in this area such as the Local Authority Pension Fund Forum (LAPFF); Institutional Investor Group on Climate Change.



Councillor Kieran Quinn, Chair, Greater Manchester Pension Fund



Councillor Paul Doughty, Chair, Merseyside Pension Fund



Councillor Andrew Thornton, Chair, West Yorkshire Pension Fund