HYMANS ROBERTSON

Sixty second summary

Pool oversight – getting the most from asset pooling

Key messages

- Asset pooling means that a range of investment decisions, which previously sat with the Local Funds, will now be delegated to/facilitated by the Pools.
- Although delegated, individual Funds' Committees continue to have ultimate responsibility for their assets and the returns generated. Lessons can be learned from the private sector's experience of increased delegation, including the need for: well-defined objectives, transparency on performance and fees and oversight of the delegated parties
- Robust and independent pool oversight can help Committees demonstrate strong governance of their Pool

Pooling: the new framework

Since the Chancellor's 2015 Autumn statement, considerable work has taken place and eight pools have been established. Assets are gradually transitioning, with more to follow, as Pools' sub-funds are launched. To date, Officers' and Committees' focus has been on establishing the Pools and setting out their investment requirements. However, as Pools increasingly take responsibility for performance, it is important that appropriate success measures and reporting are in place to allow assessment relative to these measures.

Delegation

Asset pooling represents significant change for the LGPS. For most Pools, several investment decisions that previously sat with the Local Funds are now being delegated to the companies with responsibility for the Pools e.g. the Pool's Operator. We summarise some of the key changes in the following table. As shown, the extent of the delegation varies considerably depending upon the different Pools' governance structures.

	Pre-pooling	Post-pooling
Setting objectives e.g. achieve full funding	Admin authority with advice	No change
Setting strategy e.g. split assets 40% Growth 40% Income and 20% Protection	Admin authority with advice	No change
Structure – e.g. choosing asset classes within strategy groupings	Admin authority with advice	On the whole no change, but potentially may vary per Pool
Dynamic tilts e.g. given the current market, 35% in income is better	Admin authority with advice	On the whole no change, but potentially may vary per Pool
Implementation e.g. choosing managers	Admin authority with advice	At pool level e.g. Regulated Pool Company
Implementation – stock selection	Third party investment manager (and, in some cases, in-house)	Third party investment manager (and, increasingly, Pool's in-house team)
Choosing other providers e.g. custodians	Admin authority with advice	At Pool level

Delegation is not new to the LGPS e.g. (as shown above) most Funds have appointed investment managers to pick stocks. However, post pooling, the extent of delegation has increased dramatically. As more functions are delegated

to the Pool Operator, it will be increasingly important for participating authorities to consider what oversight of, and reporting on, the functions delegated to the Pool may be appropriate.

Lessons from the Private Sector

Broader delegation of investment matters has been common in the private sector for some time, with "fiduciary managers" estimated to have "responsibility" for 15% of UK private sector pension schemes. It is worth noting an important statement on the tPR's website, *"(Trustees) can use your powers to delegate some functions, but you still retain accountability."* Although written for private sector schemes, this statement's broad thrust applies equally in the LGPS. Private sector pension schemes' relationship with fiduciary managers continues to evolve, in part due to the CMA's 2018 review, but largely due to the schemes' experience of operating with fiduciary managers. Observations on the private sector's experience which may be relevant to LGPS pooling include:

Clarity of objectives and guidelines is key – this sets out what success looks like and gives clarity on how the fiduciary manager is performing relative to these objectives. It is also worth noting that, when taking on a new mandate, fiduciary managers will stipulate the objective of their appointment, e.g. the strategy implemented will be in accordance with the mandate's guidelines and risk tolerance. Trustees are learning that this can result in significant changes to how their assets are managed e.g. a change in their equity mandate's style exposure.

Delegation is a spectrum and may evolve over time – the delegations provided to the fiduciary manager may vary across different asset classes, for several reasons e.g. the nature of the asset class or the skill set of the fiduciary team. The nature of delegations can change over time as investors gain/lose confidence in the manager's ability and, as is the case for Pools, as the manager's expertise develops.

Transparency on fees and performance can be a challenge – the CMA's review included several remedies to help address these challenges. The increasing use of an Independent Oversight to assess, and report, how the fiduciary manager is performing relative to their objectives and metrics also helps overcome these challenges.

Scope for potential conflicts can exist – examples of this include when a fiduciary invests in their own investment product. The CMA review did not find evidence that these potential conflicts caused competition problems. Nevertheless, potential conflicts exist and polices/reporting must be in place to reduce this risk.

What this means for the LGPS

LGPS pooling is not identical to private sector fiduciary management, nevertheless, there are undoubtedly strong parallels. We encourage Funds to factor in learnings for the private sector (above) when considering their relationship with their Pool company. We set out some questions below that you may wish to raise.

- What are your objectives for the Pool? Over what timeframe are you seeking to achieve these and how will the Pool company report against those objectives? How will you ensure that the sub-fund range (and timetable for opening funds) is aligned with the participating Funds' objectives, beliefs and strategic needs?
- For the sub-funds you are invested in, what delegations are in place? What reporting will be provided to assess the suitability/success of these delegations? How will the pool company report adherence to agreed policies on ESG, RI, voting and stock-lending?
- How will performance, fees and costs be reported? How will you ensure the transparency required to enable assessment of performance and value?

Please speak to your Hymans Robertson Consultant if you would like to learn more about oversight of fiduciary services and pooling arrangements.