The CIPFA Pensions Network
Susan Martin speech: Pension Fund Partnerships - the LLPP
Tuesday 13 October 2015
12:10-12:40 – 41 Lothbury road, London

Good afternoon.

I'd like to start by saying how happy I am to be speaking here today given some may have thought the Chancellor's Party Conference speech last week in Manchester completely changed the ball game!

George Graham from Lancashire County Council Pension Fund, our partners in our ambitious collaboration project, presented on this very subject at the start of the month.

Suffice to say the recent news means my presentation starts out a little differently to theirs.

With that in mind I must first address that elephant in the room.

We welcomed George Osborne's announcement of a national commission on infrastructure under Lord Adonis.

You need to look no further than our £500m infrastructure investment joint venture with Greater Manchester to see that we believe infrastructure is an essential aspect of pension fund investment.

In fact, it is also one of the founding pillars of our partnership with Lancashire. It is only through collective strength and economies of scale that funds can effectively invest in infrastructure assets. Therefore, the Chancellor's words about the LGPS using its collective strength rang true for us.

In fact, a year ago LPFA'S Chairman, Sir Merrick Cockell, wrote a Letter to the Editor at the *Financial Times* lamenting the fact that foreign funds were being invited to Number 10 and 11 to discuss investing in Britain, but LGPS funds were not.

It was with some satisfaction that the Chancellor's speech mentioned this and agreed, saying that he wanted the LGPS to invest where the Canadians already do.

However, collective strength does not mean merging. Nor does it mean funds must team up according to their regional location. It is essential that if funds are to work together they must have a similar outlook, philosophy and way of working.

Simply because they're neighbours does not mean they'll necessarily work well together.

This brings me to what I am here to talk about today.

At LPFA we strongly believe that if the long-term interests of the LGPS are to be met, funds need to set up multi-asset, collective arrangements with strong internal management capabilities which best meet their investment needs and subsequent liabilities.

This is achieved through partnerships that seek to deliver enhanced investment, liability and administration outcomes whilst retaining local accountability – through strong sovereignty agreements.

More importantly, so does Lancashire; a fund that is 230 miles away, by the way, so definitely not a neighbour, although it invests in our neighbourhood - London.

We call these arrangements Asset and Liability Management partnerships, or ALM. And we are already well underway.

As today's agenda states, in December last year we announced that we were working on such an ALM partnership with Lancashire county pension fund to create a joint £10bn fund.

Our partnership is the first of its kind within the LGPS and offers a unique proposition. Its establishment will produce a pension services operation with sophisticated, expert in-house tools and resources servicing both the existing administering authorities.

This partnership will include commonly managed liabilities, a commonly managed, jointly invested, pool of assets overseen by an FCA registered entity created by the two pension funds, and a member and employer administration function. The partnership is underpinned and supported by shared corporate resources.

Today I thought I'd give you more detail on how this partnership is progressing.

Following agreement earlier this year, we have moved on with establishing the partnership, which for now we are calling the Lancashire and London Pensions Partnership, or LLPP. It is a wholly owned pension services organisation which will manage a range of functions as I outlined earlier

Each fund will own 50 per cent of the LLPP. As such, the LPFA and Lancashire will hold the LLPP to account while still retaining responsibility – that is local accountability – for their own existing liabilities, key issues and strategic decisions.

However, the board of the LLPP will have primary day-to-day responsibility.

It will oversee the delivery of the governance of the ALM partnership, including the service level agreement responsibilities for each administering authority, and scrutinising and recommending strategic asset allocation proposals.

It is a true partnership in the full sense of the word, and one that requires the greatest level of skill and commitment to get right.

With that, I'm pleased to say that we have managed a real coup in securing a Chairman for this board. Just last week the Former Pensions Regulator Michael O'Higgins was appointed.

Michael is highly respected in both public and private sectors and has written many papers on pension reform during his academic career and whilst working in government. He has also held a number of other prestigious chairmanships and we believe that securing his services is a real testament to what we are trying to achieve.

Michael has already started working with us and we are currently recruiting for three non-executive directors to join him on this new board.

These three non-execs will also be joined by LPFA'S Board Member Skip McMullan and Lancashire County Council's Deputy Leader, Councillor David Borrow. The aspect of our partnership that has attracted most attention is the investment hub, which is being formed by pooling assets and bringing together our current in-house investment teams.

Both organisations invest directly, co-invest and have investments with external fund managers. We envisage that we will be able to do more in-house and complement each other's skills.

For example, we can build on Lancashire's excellent property investment skills and they can take advantage of LPFA's global equity buy and hold strategy. The economies gained between intelligent outsourcing and the development of internal capabilities changes with scale, which is why we are building this. It also means that we can be far more active with our portfolios.

Data suggest that, on average, internal active fees are broadly similar to external passive fees and that in-house asset management with strong governance can deliver higher absolute and risk adjusted returns than passive strategies. Internal management of alternatives can also outperform external management, at low comparative cost and with direct link to the fund's understanding of its liabilities.

The understanding gleaned from in-house management, including understanding what it costs to deliver the service, means much more effective negotiations with external managers. The most effective funds seem to have scale to use in-house resources, but supplement this with intelligent partnerships and co-investments with genuinely good external managers.

We envisage ploughing these savings and returns back into the LGPS through improved services at lower cost to our partners.

The investment hub will be an FCA regulated body allowing the direct operation of a collective investment vehicle, which is required for the pooled funds. However, current regulation restricts pooled assets to 35% of a fund's assets, a limitation that we, together with our London CIV colleagues continue to lobby to be abolished. Most recently in Manchester last week and we will be doing so again with treasury and DCLG this week.

The LLPP will also offer shared services to other funds. With the partnership likely to be the largest LGPS administration grouping it allow us to offer services at a level of LGPS administrative excellence and potential enhancements that only scale can bring.

This includes greater influence when dealing with external providers, developing in-house systems, the ability to maintain high quality data and the provision of detailed technical support and advice to all stakeholders.

Furthermore, given Lancashire's involvement as a local authority, the LLPP allows other local authority funds to avoid lengthy tender processes when entering in to the shared service arrangement.

This is an area where both LPFA and Lancashire are very experienced. Lancashire has provided pensions administration services to the local authority, police and fire authorities in its area for many years whilst LPFA has over 30 years' experience with third party contracts for local authority and fire partners.

Of course we are not the only game in town. Whilst we commend several funds for looking ahead to find a viable solution to reduce their deficits we don't think common investment vehicles are the answer. Running a pension fund is not the same as asset management; a simple comparison of cost and return is insufficient to evaluate different proposals.

In planning and operating a solvent pension scheme, the timing and amounts of investment cash flows is of at least equal significance to annualised rates of return since the ultimate objective is meeting pension payments as they fall due. This is our first and foremost responsibility. National, single-asset class CIVs miss the opportunity to pool, develop and enhance the existing investment teams of LGPS administering authorities.

Furthermore, they tend to be voluntary in nature which could result in sub-optimal scale and are less likely to be able to exploit the link between excellent data quality and reduction of liabilities, which can be achieved through a full partnership.

So in closing, I'm pleased to say that we are making real progress. We've had positive responses from other authorities as well as ministers and civil servants who find the moves we are making of interest.

These are conversations that we welcome as we look to grow this partnership from £10bn fund to a £40bn. A fund of this size would enable collaborating funds to participate in investment opportunities that are currently unobtainable or complicated to access on a small scale, such as infrastructure.

Our partnership is groundbreaking in the LGPS so we have always known that this wouldn't be easy. Along with the operational challenges that pulling two of the largest funds in the scheme together brings, we need to have clarity at every step of the way.

However, the most important decisions are still ahead of us. November sees our application for FCA accreditation lodged as well as another government consultation in to the future of the LGPS.

Thank you for listening and I look forward to talking with many of you over lunch, or seeing some of you at the NAPF conference tomorrow.

Thank you.