

## Project Brunel: Initial proposal to DCLG on investment pooling

A. Asset pool(s) that achieve the benefits of scale		Initial proposal, subject to development in the July proposal
<b>A1</b>	<p>Anticipated size of the pool</p> <p>Throughout this proposal, we describe the pool proposed by Project Brunel as a Collective Asset Pool overseen by a Joint Committee, or the “Brunel CAP”</p>	<p>Project Brunel aims to achieve the £25 billion scale quickly. At least ten Founder Funds are envisaged: Avon, Buckinghamshire, Cornwall, Devon, Dorset, the Environment Agency, Gloucestershire, Oxfordshire, Somerset and Wiltshire. These Funds had total assets under management of £23 billion at March 2015.</p> <p>For operational efficiency, there would be a maximum of 12 Founder Funds. The pool could, therefore, work with two more like-minded Funds. There is a strong preference for a clear list of Funds at an early stage so that all can input on an equal basis into the detailed July proposal.</p>
<b>A2</b>	<p>Assets proposed to be held outside the pool</p>	<p>Founder Funds are looking to include all assets within the Brunel CAP, but are open to accessing investment opportunities e.g. infrastructure, passive equities using a national initiative.</p> <p>Founder Funds manage some assets internally. These total c£1.0 billion. These will be managed within the pool, with the mechanism for achieving this being confirmed in the July proposal.</p>
<b>A3</b>	<p>Type of pool including legal structure</p>	<p>The structure will be a Collective Asset Pool (“CAP”) overseen by a Joint Committee, to be established under existing legislation. This allows Founder Funds to retain both legal and beneficial ownership of pooled assets. It may be necessary to amend regulations to confirm that the Environment Agency has clear legal authority to delegate investment powers into a Joint Committee. The active support of the relevant Departments is sought for this.</p> <p>The Administering Authorities will delegate most of their investment powers to the Brunel Collective Asset Pool (the “Brunel CAP”), retaining strategic asset allocation decisions in respect of pooled assets. These decisions will be implemented by allocation between approximately 20 Sub-Funds offered by the Brunel CAP. This will allow a wide but clear choice, thus meeting the democratic accountability and strategic asset allocation criteria in the DCLG’s 25 November guidance paper, paragraphs 3.25 and 3.28.</p> <p>Crucially, each Sub-Fund will offer access to a given market or style of investment, with decisions between investment managers held within each Sub-Fund made at the Brunel CAP level. Participating Authorities will not have discretion between investment managers within a Sub-Fund: there may be more than one investment mandate within any given Sub-Fund, but all Participating LGPS Funds will hold mandates in equal ratios within that Sub-Fund.</p>

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		<p>The Administering Authorities of the Brunel CAP intend to enter into a long term contractual agreement between them. Permanence will be delivered by clauses relating to the pricing of Sub-Funds (in effect unitisation pricing) and withdrawal notice period and terms. These contractual terms will recognise the permanence of the new overall UK pooling structures,</p> <p>The Brunel CAP will monitor other delivery models to ensure that all pooling is conducted in the most advantageous way.</p>
<b>A4</b>	<p>How the pool will operate, the work to be carried out internally and services to be hired from outside.</p>	<p>There will be an Operations Group to carry out much of the work internally. Existing investment teams in the Founder Funds will work together to operate the Brunel CAP, making and managing appointments of Investment Managers within the Sub-Funds.</p> <p>Specialisation will be achieved through the use of five Portfolio Construction Groups. Transfers of employment between Founder Funds are not expected.</p> <p>A custodian will be hired to provide unitisation services. Administration, depositary, audit, tax and legal services will also be hired from outside. Other advisory services may also be required by the Brunel CAP and existing Framework Agreements will be used when applicable.</p> <p>Investment managers will engage with the Participating Funds using clusters of substantially identical Investment Manager Agreements.</p>
<b>A5</b>	<p>Timetable for establishing the Brunel CAP and moving assets into the pool. How progress will be reported transparently against that timetable.</p>	<p>The CAP structure can be established within 6-9 months of obtaining approval from DCLG, so Project Brunel proposes a commencement date for the Brunel CAP of April 2017. Asset transition planning will start before this, not least to avoid decisions in 2016 / early 2017 at a Founder Fund level that would complicate the pooling process.</p> <p>A two year period for transferring listed assets is expected, subject to analysis on transaction costs for mandate rationalisation. Efficient transfer of unlisted assets, including those with contractual tie-ins, may reasonably be completed within 10 to 15 years. More detail, including reporting proposals, will be provided in July.</p>

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<b>B. Strong governance and decision making</b>		<b>Initial proposal, subject to development in the July proposal</b>
<b>B1</b>	Assurance to individual Funds that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members.	Further detail on governance and reporting is being developed, and will be covered in the July proposal.
<b>B2</b>	At the pool level, adequate assessment and management of risk, a long term view for investment implementation decisions and a culture of continuous improvement is adopted.	<p>The Brunel Pool expects to make appropriate use of external advisors and data aggregation techniques at the Oversight Group and Portfolio Construction Group level.</p> <p>Founder Funds are mindful that, just as their existing processes do not require oversight by the Financial Conduct Authority, neither does the CAP structure. Nonetheless, during development of the July proposal, the FCA processes for risk and process control will be reviewed so that the Brunel Pool can operate at the highest level of risk assessment and management, take a long term perspective for investment decisions and establish a culture of continuous improvement. These matters will be covered fully in the July proposal.</p>
<b>B3</b>	Governance structure for the Brunel CAP, including the accountability between the pool and elected councillors, and use of external scrutiny.	<p>There will be an Oversight Group with a scrutiny, challenge and ratification of process role. Chairs of Pension Committees, as elected councillors, will normally sit on this Group, on the basis of one seat for each Founder Fund. With no more than 12 Founder Funds, the Group will be a practical working size.</p> <p>There is no legal requirement for political balance or member representation on the Oversight Group, but these issues will be considered further, as will the position of the Environment Agency.</p> <p>The Oversight Group will include a Chair, independent of any of the Founder Funds, appointed from outside, to bring direct investment experience.</p> <p>These arrangements, including external scrutiny, will be considered further in the July proposal.</p>
<b>B4</b>	Mechanisms by which the authorities can hold the Brunel CAP to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.	<p>The Oversight Group will provide the primary formal mechanism by which Pension Committees can hold the Brunel CAP to account.</p> <p>The Operational Group will be responsible for providing information to Pension Committees of a quality sufficient to deliver assurance that investment are well managed and that strategy is being implemented effectively. This will include information on the Sub-Funds sufficient to enable Pension Committees and their advisors to make asset allocation decisions that fully allow for liability, deficit and contribution stability</p>

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		considerations. Founder Funds are expected to retain investment advisors but typically with revised roles, focussing on these matters.
<b>B5</b>	Decision making procedures at all stages of investment, and the rationale underpinning this.	These policies and processes will be defined more closely by the July proposal. The Founder Funds share a clear intent that investment manager appointments will be considered and determined by the Operations Group, and its Portfolio Construction Groups. The Oversight Group will be responsible for ratifying the processes used rather than individual investment manager appointments.
<b>B6</b>	Shared objectives for the pool, and any policies that are to be agreed between participants.	Work has started in these areas and will be reported in July.  Part of the initial work will focus on practical policies to achieve fair sharing of transaction costs between Founder Funds across the Brunel CAP to effect the mandate rationalisation needed to deliver savings.
<b>B7</b>	Resources allocated to the running of the pool(s), the governance budget, the number of staff needed and the skills and expertise required.	These matters will be covered in the July proposal. Between them, the Founder Funds have substantial expertise, and redeployment, of role rather than location or employer, will be the primary mechanism used.
<b>B8</b>	Handling of environmental, social and corporate governance policies by the pool.	Project Brunel has begun work on shared investment beliefs to establish common policies to as large an extent as possible.  Within the Founder Funds, there is considerable experience and recognised global leadership of responsible investment, broadly defined as generating better returns by investing in companies and assets that contribute to the long term sustainable success of the global economy and society, adopting best practice collective governance with appropriate oversight, prioritisation, delegation and decision making at the right level.  Further detail will be provided in the July proposal.
<b>B9</b>	Individual Funds acting as responsible, long term investors through the pool. Determination and enactment of stewardship responsibilities by the pool.	Substantial commonality has been identified between Founder Funds in terms of being long term investors, investing strategically in productive assets that contribute to economic activity, such as equities, bonds and real assets, thereby aiming to earn sustainable and sufficient returns on their assets.  The Brunel CAP will provide Sub-Funds for its Founder Funds that enable them to continue this responsible approach. There is recognition that there are some differences between Founder Funds' starting positions on these questions and the development of policies will be mindful of this.
<b>B10</b>	Public reporting of net performance of each asset class by the Brunel CAP, to encourage the sharing of data and best practice.	The Brunel CAP will look to work with other pools to facilitate consistent public reporting of the net performance of each asset class. The Sub-Fund approach will facilitate this. More detail will be provided in July proposal.

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<b>B11</b>	Extent of use by benchmarking by individual Funds to assess their own governance and performance and that of the Brunel CAP, for example by undertaking the Scheme Advisory Board's key performance indicator assessment.	The Brunel CAP will take a fully transparent approach, to facilitate Founder Funds' work in this area. In particular, there is an understanding that overall investment performance will result from a combination of strategic asset allocation decisions taken by Pension Committees and granular Sub-Fund decisions and appointments handled by the Operations Group.  More detail will be provided in the July proposal.
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<b>C. Reduced costs and excellent value for money</b>		<b>Initial proposal, subject to development in the July proposal</b>
<b>C1</b>	<p>Delivery of savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.</p> <p>Approach to comparison of fees and net performance in each listed asset class compare to a passive index.</p>	<p>Project Brunel is establishing a savings projection model. Net savings are expected after the first 2 years, once the balance between operational savings and transitional costs becomes positive.</p> <p>The estimated predictable savings from mandate rationalisation and fee renegotiation when transition is complete, after 10 – 15 years, is £16 million a year across the ten Founder Funds. Additional operational costs, of approximately £1.5 million, including the provision of a unitisation service by a single external custodian, are expected to reduce this. Section 7 of the PwC February Report details the assumptions underlying the savings model.</p> <p>The Founder Funds are open to seeking further savings from specific sources, such as may be delivered by more internal management or more passive management. These approaches are not yet agreed and may be linked to moving some assets into a regulated environment or into national passive procurement or other national initiatives.</p> <p>More widely, the Founder Funds share an aspiration to make the Brunel CAP work for them, and to deploy long term investment approaches consistent with scale. There is an aspiration to make total improvements in net investment return over the Founder Funds of around £70 million a year. The PwC Feasibility Report comments further on the distinction between predicable savings and aspirational improvements.</p> <p>It should be possible to comment on monitoring processes against passive indices in the July proposal, but Project Brunel will seek to work with other pools to establish a consistent approach.</p>
<b>C2</b>	<p>Consideration of setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period.</p>	<p>The Operations Group will draw on the substantial expertise in this area that already exists in the Founder Funds. Each of the Portfolio Construction Groups will be monitored as to their success in setting risk-adjusted long-term targets for active managers.</p> <p>This question will be addressed further in the July proposal.</p>
<b>C3</b>	<p>Transparent assessment of investment costs and fees as at 31 March 2013.</p>	<p>Much of this assessment was originally carried out two years ago in order to inform subsequent renegotiations with investment managers of the South West Funds. Further details will be provided in the July proposal.</p>
<b>C4</b>	<p>Transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.</p>	<p>This assessment has been started. It is designed to feed into the cost savings projection model, which considers scope to achieve fee reductions through mandate rationalisation and increased scale.</p>

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		Detail will be provided in the July proposal.
<b>C5</b>	Detailed estimate of savings over the next 15 years.	To be provided in July proposal.
<b>C6</b>	Detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.	<p>An assessment of implementation costs has commenced as part of the modelling described in C1. This includes legal, tax, procurement advice and costs arising from detailed design, implementation and asset transition. Detail will be provided in the July proposal.</p> <p>There are some legacy illiquid assets that will have to remain outside the pool for contractual reasons. The governance of the assets will be handled by the Brunel CAP Operations Group. It is anticipated that as these investments are run down over the longer term the proceeds released will be transitioned to the pool.</p> <p>In principle, costs will be divided across Founder Funds, either equally or in proportion to relevant assets.</p>
<b>C7</b>	Proposal for reporting transparently against forecast transition costs and savings. Approach to reporting fees and net performance.	To be provided in July proposal.

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<b>D.</b> Improved capacity to invest in infrastructure	Initial proposal, subject to development in the July proposal
<b>D1</b>	<p>Proportion of participating individual Funds currently allocated to infrastructure, both directly and through funds, or “fund of funds”.</p> <p>The Founder Funds recognise that infrastructure can be an attractive investment class for pension funds with long term, stable cash flows and controlled risks.</p> <p>Between them the Founder Funds have a total strategic target allocation to infrastructure of approximately £820 million as at 31<sup>st</sup> March 2015. Of this, £580 million is already committed to specific investment and £230 million of this has been drawn down.</p>
<b>D2</b>	<p>Potential development or acquisition of the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or “fund of funds” arrangements.</p> <p>We recognise that infrastructure can be an attractive investment class for pension funds with long term, stable cash flows and controlled risks. Funds within the Brunel CAP have been allocating to infrastructure since 2007. To maximise our capabilities in infrastructure we will work within the Brunel CAP to build up the focus and capacity on infrastructure, and also seek to collaborate with other pools to support national infrastructure initiatives. Further detail will be provided in the July submission.</p>
<b>D3</b>	<p>Proportion participating individual Funds intend to invest in infrastructure, ambition in this area going forward, derivation of that amount.</p> <p>All infrastructure investments will need to be acceptable against fiduciary criteria that meet Founder Funds’ overall investment objectives.</p> <p>Within this criterion, and recognising that strategic allocation decisions will remain the prerogative of Founder Funds, Project Brunel plans to work with Founder Funds between February and July to define a substantial ambition to invest in infrastructure. This will enable development of fuller proposals by July.</p>