

LGPS Central Limited

Pillar 3 Disclosures

March 2021

1. Background

- 1.1. LGPS Central Limited was established by eight Midlands-based local government pension funds to manage their pooled investment assets. The Partner Funds are Cheshire, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands and Worcestershire. The Company is jointly-owned on an equal-shares basis by the eight Partner Funds, who have combined assets of approximately £48 billion, managed on behalf of around 1 million LGPS members and over 2,300 participating employers.
- 1.2. The Company was launched in April 2018, since which time it has become responsible for the management of around £21.8 bn of its Partner Funds' assets, including £13.1 bn in its Authorised Contractual Scheme (ACS) and approximately £8.7 bn in a range of advisory and execution mandates (February 2021). The volume of assets is expected to grow rapidly over the next few years as, in partnership with the Company's Partner Funds, new ACS sub-funds are developed and launched into which Partner Funds' assets will transition.
- 1.3. The Company operates as an Alternative Investment Fund Manager (AIFM), and as the manager and operator of a collective investment vehicle (the LGPS Central ACS). The Company is authorised and regulated by the Financial Conduct Authority (the FCA).
- 1.4. We are permitted to omit required disclosures if we believe that the information is immaterial and would be unlikely to change or influence the decision of the reader. In addition, we may omit required disclosures if we believe that the information is regarded as proprietary or confidential. We have made no omissions on the grounds that it is immaterial, proprietary or confidential.

2. Risk Management Objectives and Policies

2.1. LGPS Central Limited has in place robust policies and procedures for the identification, monitoring and management of risk, as set out in its Risk Management Framework. The objectives of the Risk Management Framework are to:

- Set out a framework of tools and techniques which enable consistent and proactive understanding of risks and an approach to manage them;
- Define the risk management standards that LGPS Central Limited seeks to implement across both investment and non-investment risks, including corresponding roles and responsibilities;
- Establish and maintain a consistent and independent framework for risk appetite-setting and to identify, measure, monitor, manage and report significant risks across LGPS Central Limited;
- Formalise the governance structure for risk oversight by describing the role of committees and functions across LGPS Central Limited in respect to risk management.

2.2. When establishing its procedures and structures, LGPS Central Limited takes into account the principle of proportionality which allows procedures, mechanisms and the organisational structure to be calibrated to the nature, scale and complexity of the Company's business, the investments it manages and the nature and range of activities carried out in the course of its business.

2.3. LGPS Central Limited's approach to risk management is centred on the 'Three Lines of Defence' model, as summarised below:

- **First Line: Management Functions.** Management of each business area is responsible for continually identifying, assessing and managing the risks within their area of duty on a day-to-day basis, regarding risk management as a crucial element of the everyday job. Managers identify and document key risks in a departmental risk register and control and allocate responsibility for them to specific staff.
- **Second Line: Risk and Compliance Functions.** These functions, assisted by other central functions such as Legal and Finance, support the ARCC. The Risk function facilitates the development and implementation of processes whereby management identifies, assesses and manages the risks in their business areas and ensures that risk policies are complied with. The Compliance function identifies and assesses compliance risk and monitors adherence to regulatory standards. This second line provides policy direction and oversees and monitors the risk framework to determine whether all key risks are being identified, assessed and controlled by management in a manner commensurate with the Company's risk appetite and regulatory needs.

- **Third Line: Assurance Function.** This line, provided by Internal Audit (this function has been outsourced to KPMG), objectively assesses the adequacy and effectiveness of the processes within the first two lines of defence and provides periodic assurance on the control environment across the Company. An internal audit plan is reviewed and approved by the ARCC on an annual basis and is formally reassessed and refreshed as necessary at the half-year. Findings from internal audits are discussed and agreed with management, with review dates set for follow-up of outstanding actions. A summary of findings and overdue actions is reported to the ARCC and the Board of LGPS Central Limited.
- 2.4. The Board of Directors, whilst maintaining the overall responsibility for monitoring risk management collectively, has established an Audit, Risk and Compliance Committee (ARCC), which reports to the Board in respect of risk.
- 2.5. LGPS Central Limited has implemented risk management systems to identify, measure, manage and monitor all risks relevant to the AIFs' investment strategies and to which the AIFs are or may be exposed. The Company has an investment strategy process which evaluates each investment strategy and takes into account the nature of the position and its size within the context of the overall strategy of the AIF to ensure that the AIF's risk profile corresponds to its size, portfolio structure, investment strategies and objectives and is not compromised by any particular position or strategy which may not fit within the defined parameters.
- 2.6. LGPS Central Limited has put in place a Risk Appetite Statement and Risk Tolerance Limits, which articulate the amount of risk LGPSC is willing to take and provide boundaries defining when potentially too much, or too little, risk is being taken. This provides guidance to enable management to take on the "appropriate" risks and the "appropriate" amount of risk as part of the pursuit of its strategic objectives.

3. Capital Resources

- 3.1. The regulatory capital of LGPS Central Limited was provided by its shareholders, the Partner Funds. In January 2018, the Partner Funds provided £16 million of capital in a combination of equity and debt.
- 3.2. At the end of March 2020, the Company had cumulative retained losses of £3.7 million, made up of pre-trading costs incurred during Company set-up (£4.4 million) net of retained profits for 2018/19 and 2019/20 (£659,000). These losses have the effect of reducing Tier 1 capital, as shown in the following table which sets out the amount of capital resources available to the firm following the audit of its 2019/20 financial statements.

Type of Capital	Amount March 2020 (Audited) (£000)
Tier One Capital	
- Ordinary 'B' Shares	10,520
- Retained Losses	(3,742)
Total Tier One Capital	6,778
Tier Two Capital	
- Preference 'C' Shares	685
- Loans	4,795
Total Tier Two Capital	5,480
Total Capital	12,258

4. The Regulatory Capital Process

- 4.1. LGPS Central Limited has a robust process in place for the preparation, review and approval of its Internal Capital Adequacy Assessment Process document (ICAAP).
- 4.2. LGPS Central Limited believes that it has sufficiently robust internal controls to identify and manage risks, and that these are accurately reflected in the ICAAP. The Pillar 2 analysis, as set out in the ICAAP, is clearly linked to the risk register generated through the Company's embedded risk management procedures.
- 4.3. The Board is responsible for approving the ICAAP, on the recommendation of the Audit, Risk and Compliance Committee.

5. Sources of Risk

- 5.1. The Company has identified the following items as the sources of risk for which the provision of capital is required under its Pillar 2 calculation.

Operational Risk

- 5.2. Operational risk is considered by evaluating individually the financial implications for the Company of a range of scenarios ensuing from operational failures, such as the failure of the provider of an outsourced service or an IT failure and summing the results of those individual assessments. Most of the risks requiring capital provision for LGPS Central Limited fall under operational risk.

Credit Risk

- 5.3. LGPS Central Limited is exposed to credit risk with regard to its revenue stream from clients, although the nature of its funding, through the Cost-Sharing Agreement with its Partner Funds, serves to mitigate this to a large extent. In addition, the Company is exposed to credit risk with regard to amounts deposited with treasury counterparties. In order to manage that risk, the Company sets certain limits and parameters for its treasury activity and monitors the creditworthiness of counterparties.

Liquidity Risk

- 5.4. This is the risk that LGPS Central Limited does not have the resources to meet its ongoing expenditure obligations. Due to the nature of the Company's funding arrangements, (its costs being funded one quarter in arrears by Partner Funds), as well as the underlying commitment from Partner Funds to provide sufficient regulatory capital, liquidity risk is not considered to be a significant risk for LGPS Central Limited; however, a small amount of provision has been made.

Securitisation Risk

- 5.5. LGPS Central Limited has not entered into securitisation transactions, and therefore is not exposed to securitisation risk.

Insurance Risk

- 5.6. Insurance Risk refers to the risks arising from the uncertainty inherent in needing to meet insurance obligations. This is not relevant to LGPS Central Limited.

Pension Obligation Risk

- 5.7. As LGPS Central Limited participates in a defined benefit pension scheme, it is exposed to pension obligation risk. Considered in isolation, the financial implications of this risk are potentially significant. However, the supplementary deed, to which all of the Partner Funds are signatories, immunises the Company against this risk by requiring that residual pensions obligations will be funded by the Partner Funds.

- 5.8. Relying on the provisions of the supplementary deed, no capital is required in respect of pension obligation risk.

Concentration Risk

- 5.9. Concentration risk refers to the risks arising from the Company's exposure to organisations which are connected to one another or which are in similar economic sectors, geographic areas or lines of business. Since all of LGPS Central Limited's investors are UK local authorities, specifically the pension funds operated by those authorities, LGPS Central Limited is exposed to concentration risk. The relevant risk here is the risk of loss of income following the withdrawal of one or more Partner Funds and/or withdrawal from a particular product or group of products. This is provided for under business risk (see below) and accordingly no further provision has been made under concentration risk.

Residual Risk

- 5.10. This refers to the risk that credit risk mitigation techniques are less effective than expected. For LGPS Central Limited, no significant residual risk has been identified, and accordingly no capital is allocated for residual risk.

Business Risk

- 5.11. Business risk refers to risks relating to the Company's business plan, including its income stream and the risk of changes in the Company's operating environment rendering the business strategy inappropriate. It also refers to risks arising from the Company's remuneration policy.
- 5.12. The most significant business risk is that the Company is unable to generate the income that it anticipates in its budget/medium-term forecasts, which may occur for a number of reasons including lack of investment in the products which the Company launches. An amount has been provided against business risk for such a shortfall of income.
- 5.13. Since LGPS Central Limited's remuneration policy is straightforward and its financial implications are fully reflected in the approved budget, there are not considered to be any significant risks arising from the remuneration policy, and accordingly no capital is required in respect of such risk.

Interest Rate Risk

- 5.14. This refers to a range of risks defined by the FCA as 're-pricing risk', 'basis risk', 'pipeline risk' and 'optionality risk'. It is not considered that any of these represent a significant risk for LGPS Central Limited.

Other Risks

- 5.15. No other significant risks have been identified in respect of LGPS Central Limited which would require the allocation of capital.

6. Regulatory Capital Requirement

- 6.1. The following table provides a summary of the Company's position with regard to regulatory capital as at 31st December 2020.

	31 Dec 20 £000
Pillar 1 Capital Requirement	2,887
Pillar 2 Capital Requirement	4,618
Wind-Down Assessment	3,831
Total Capital Requirement (Highest of Above Three)	4,618
Capital Buffer	1,155
Total Capital Requirement Including Buffer	5,773
Available Assets	12,258
Regulatory Capital Headroom	6,485
Ratio of Available Assets to Total Capital Requirement Including Buffer	212%

- 6.2. As can be seen from the above table, the pillar 2 calculation is currently the dominant factor in the Company's regulatory capital calculation. The following table summarises the Company's provision for capital in respect of Pillar 2.

	31 Dec 20 £000
Market Risk	422
Credit Risk	317
Operational Risk	2,530
Business Risk	1,345
Liquidity Risk	4
Total Pillar 2 Capital Requirement	4,618

- 6.3. In conclusion, having considered and evaluated the risks to which LGPS Central Limited is exposed, the Company believes that it has sufficient available assets to fulfil its regulatory capital requirement, and furthermore expects this to be the case for the medium term.

7. Remuneration

- 7.1. The Board has established a Remuneration Committee, the core purpose of which is to oversee and establish a formal and transparent procedure for developing and implementing policy on executive and non-executive remuneration, including:
- setting the remuneration packages for individual executive and non-executive directors, senior staff and others, and
 - in the case of executive and non-executive directors, to make recommendations for approval to the Shareholders.
- 7.2. The Remuneration Committee is made up of:
- John Nestor (Chair of the Committee and Non-Executive Director)
 - Joanne Segars (Chair of the Board)
 - Susan Martin (Non-Executive Director)
- 7.3. The Company has adopted a Remuneration Policy, which is developed by the Remuneration Committee and subject to majority shareholder approval. The Remuneration Policy supports the Company's culture and purpose, as follows:
- The Company's culture is based on a public service ethos of openness, accountability, professionalism, honesty, integrity, fairness and trust.
 - The Company's purpose is to align its activities with the interests of its clients and shareholders (stakeholders) and, ultimately, to create sufficient value for the Partner Funds to meet their pension obligations in full.
- 7.4. The Remuneration Policy will deliver fair rewards to all staff who contribute positively to the Company's culture and purpose, and will recognise in particular those staff members whose contribution has consistently been exceptional, so as to create alignment with the interests of its Stakeholders.
- 7.5. The Company does not pay bonuses. It does not have the commercial objectives of private sector asset managers and so has no need to incentivise behaviour which drives profitability above that required for the Company to be sustainable and which may otherwise create incentives which are not aligned with those of its stakeholders. No sign-on or severance payments were made to staff during the year.
- 7.6. The reward elements of the Company's Remuneration Policy are restricted to salary, pension and life insurance. The salary band, pension and life insurance provision are set by reference to its staff grades.
- 7.7. The following table provides a summary of remuneration payable to directors and other employees in 2019/20.

	Salaries £000	Social Security Contributions £000	Employer's Pension Contributions £000	Total £000
Directors	636	82	-	718
Other Staff	3,449	383	733	4,565
Total	4,085	465	733	5,283