MEETING
COUNCIL
DATE AND TIME
TUESDAY 19TH OCTOBER, 2021
AT 7.00 PM
VENUE
HENDON TOWN HALL, THE BORROUGHS, LONDON, NW4 4BQ

Dear Councillors,

Please find enclosed additional papers relating to the following items for the above mentioned meeting which were not available at the time of collation of the agenda.

Item No	Title of Report	Pages
12.1	Report of the Section 151 Officer - London Local Government Pension Scheme (LGPS) Collective Investment Vehicle Limited (London CIV) Regulatory Capital	3 - 8

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AGENDA ITEM 12.1

Council

19 October 2021

Title	**London LGPS CIV Limited (London CIV) Regulatory Capital**
Report of	Director of Resources
Wards	All
Status	Public
Urgent	No
Key	No
Enclosures	None
Officer Contact Details	George Bruce, Head of Pensions george.bruce@barnet.gov.uk 0208 359 7126

Summary

The London CIV (LCIV) is a company owned by the 31 London borough pension funds and the City of London pension fund to facilitate joint investment management. Council agreed in 2014 to become an LCIV shareholder. This report seeks agreement to changes to the LCIV Articles and Shareholder Agreement so that the £150,000 of capital advanced is classified as equity rather than redeemable debt.

Officer Recommendations

That Council agree to delegate approval and signing of the changes to the LCIV's Articles of Association and Shareholder Agreement to the Director of Resources.

1. BACKGROUND

1.1 The LCIV was established in 2014 and is owned equally by London Boroughs (including City of London). Its purpose is to enable collective appointment and monitoring of fund managers for Borough pensions funds thereby both reducing the cost of investment management and improving the appointment and monitoring process by having a shared dedicated and skilled team. LCIV is regulated to offer investment management services to London Boroughs by the Financial Conduct Authority and must therefore maintain capital in accordance with Regulator's guidance. Each London Borough Pension Fund contributed £150,000 when LCIV was established, which in the case of the Barnet Pension Fund was treated as a long-term investment.

1.2 The establishing documents of the LCIV; articles and shareholders agreement, classified the capital advances by London Boroughs as redeemable loans, in that a London Borough could request a repayment. The Financial Conduct Authority (FCA) who initially approved the capital structure have now concluded that the redeemable nature of the capital does not meet the definition of regulatory capital used by the FCA. This does not require LCIV to raise further capital or for boroughs to contribute further capital. It is rather a case of amending the key constitutional documents (Articles and Shareholders Agreement) to ensure that existing capital falls within the definition set out in regulations by reclassification as equity and removing the ability of London Boroughs to require LCIV to repay the capital.

1.3 Officers have reviewed the proposed changes to the LCIV Constitutional Documents and are satisfied that the changes are limited in scope to achieve the purpose discussed above. As mentioned above, the Barnet Pension Fund has always treated the capital advanced as a long-term investment. In the last year Barnet Pension Fund has significantly broadened its use of LCIV products by investing in four recently launched funds and estimated savings through using LCIV in the last financial year was £435,000. Therefore, there is no expectation of seeking to withdraw from LCIV and savings to date have greatly exceeded the cost of establishing and operating LCIV.

1.4 A more detailed discussion of the changes required is provided in section 5.4 below.

2. REASONS FOR RECOMMENDATIONS

2.1 If changes to the LCIV regulatory capital are not implemented, then the FCA could lose confidence in the LCIV's ability to make these changes. The FCA could withdraw the LCIV's "licence to operate". This is not an option as the LCIV manage £24bn of London Pension Fund's LGPS assets for a large number of beneficiaries and require ongoing FCA authorisation to operate.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 The option of not approving the changes is not supported because of the implications set out in 2.1 and the disruption that would cause to the investment of Barnet Pension Funds' assets.

4. POST DECISION IMPLEMENTATION

4.1 Completion requires the agreement of all shareholders. If this is achieved, no further action is required by the Council.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 Good management of the Pension Fund will minimise the cost of providing benefits thus enabling funds to be directed to Council priorities as set out in the Council's Corporate Plan for 2019-2024.

5.2 Resources (Finance and Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 LCIV is not seeking any additional capital. London CIV has incurred costs in relation to legal and accounting advice which is estimated to cost around £100,000. However, London CIV has confirmed that this can be accommodated within existing budget provision in the current year.

5.3 Social Value

5.3.1 There are no specific social value issues arising out of this report, however membership of the Pension Fund ensures the long-term financial health of contributing employees on retirement.

5.4 Legal and Constitutional References

5.4.1 LCIV was established by the London Local Authorities in 2014 as a collective venture to facilitate the pooling of Local Government Pension Scheme (LGPS) fund assets. It was authorised by the Financial Conduct Authority (FCA) in 2015. It was initially a voluntary arrangement however the government mandated LGPS pooling in 2015 and there are now 8 LGPS pools. There are now 32 shareholders. The Company is governed by the Companies Act, Articles of Association ("AA") and a contractual Shareholder Agreement ("SHA") which retains certain matters for decision by shareholders and rules and regulations of the Financial Conduct Authority ("FCA"). The SHA is a contractual document which complements the Companies Act and AA, in particular by setting out governance arrangements specific to London CIV as a collective LGPS pooling venture. These include a mechanism in the (unlikely) eventuality that a local authority might decide to leave the pool to join another pool. The AA and SHA were first agreed in 2015 and some amendments have been made since that time to update the governance framework and to change the description of the business purpose of the company so that it has more flexibility in the range of services and products it provides.

5.4.2 The original decision to participate as shareholders in the London CIV (which was a new company) was, on legal advice, taken at Council on 8 April 2014. However this is a straightforward decision about a relatively minor amendment to the AA and SHA which is necessary as a matter of urgency to meet regulatory requirements to ensure London CIV continues to meet its "licence to operate" requirements. It relates to ensuring that the characteristics of the share capital meet the definition of equity rather than debt and requirements to meet the tests for regulatory capital. Each shareholder holds one A share which is a voting share and 150,000 B shares which contributes regulatory capital.

5.4.3 LCIV is authorised and regulated by the FCA as an alternative investment fund manager ("AIFM"). As such it is required to hold regulatory capital. The share capital must meet certain technical requirements to count as regulatory capital. LCIV must also have an adequate level of regulatory capital and the minimum level is calculated using a designated formula. It is an absolute requirement that LCIV holds capital that meets the technical requirements and sufficient regulatory capital to retain FCA authorisation to perform its functions. The FCA requires the company to amend its AA and SHA to amend the characteristics of the "B" shares to meet the technical requirements for them to be counted as regulatory capital. The FCA's concerns have arisen because the shares are redeemable and classified as debt in the accounts. LCIV's external auditors have also confirmed that the proposed changes will also result in the re-classification as equity rather than debt on the company balance sheet.

5.4.4 It is not a change to the amount of regulatory capital that the Company is required to hold; there is no requirement to increase the capital held by the Company so no requirement for the boroughs to increase their holdings of "B" shares as a consequence of these changes. This change of itself does not increase the likelihood of a future requirement to increase regulatory capital.

5.4.5 The changes do not affect or impact any of the investment funds operated by the Company or the investors in those funds. No other document or agreements require amendments.

<u>The Changes</u>

5.4.6 The basic change is removing references to the "B" shares being redeemable. The key issue that then arises for boroughs is whether there remains a mechanism whereby shareholders can exit the pool and LCIV as a company and to request the company to purchase their shares. In practice if this happens it will be a very carefully considered decision since LGPS funds will be invested in pooled investment funds operated by LCIV and will need to be transitioned elsewhere and it will also be necessary to settle any liabilities. So, this will be a carefully planned change and considered decision. Given that pooling is mandated by government it will also be necessary for the local authority to join another pool. In these circumstances the changes to the AA and SHA have been made such that it will still be possible for shareholders to request the company to purchase shares following Companies Act procedures. At present the "B" shares will be purchased by the company at par, subject to any liabilities also being met, at the end of a defined period (on a minimum of twelve months' notice) on the request of a shareholder to the company if a number of gating provisions are met. The gating provisions are:

- that the company has sufficient regulatory capital either because it holds it already or because it raises regulatory capital from the remaining shareholders to match that of the exiting shareholder, and
- the FCA consent to the "B" shares being purchased by the company.

5.4.7 Although there is no guarantee that any "B" shares would be bought back, the Shareholders' Agreement sets out detailed provisions on how LCIV can request additional regulatory capital from the shareholders to fund a shareholder's exit and what happens if one or more shareholders do not contribute. Under the proposed amendments, shareholders are still able to request the company to purchase their “B” shares at par, subject to any liabilities also being met. London CIV is still able to purchase the shares provided certain conditions are met which are contained in the FCA capital requirements and which are reflected in the current gating provisions set out above. The “B” shares are not redeemable and it is in the Company’s discretion whether to purchase the “B” shares. A shareholder still has the right to request a purchase of its shares, and the Company may purchase a shareholder’s shares but there is no formal obligation for the Company to purchase shares, no time limit by when “B” shares would be purchased and the documents do not contain provisions on how the Company would raise replacement capital. However, just as now, provided the Company has sufficient regulatory capital and the FCA consents the Company can purchase “B” shares on the request of a shareholder.

5.4.8 In order to increase options in case a shareholder wishes to leave and the Company does not agree to buy back the shareholder’s shares, the amendments also build in a mechanism for the shareholders to meet and seek to reach agreement amongst themselves to buy the “B” shares, with LCIV facilitating those discussions between transfers and agreeing to register any resulting transfers of shares between shareholders. The position on liabilities for an exiting shareholder remains the same. The “B” shares remain the regulatory capital of the company designed to be permanent capital. Shareholders still have the right to request that the company purchases their shares at par and provided the company would have sufficient regulatory capital and the FCA agrees, then the company is able to purchase the shares.

5.5 **Risk Management**

5.5.1 Risk management is central to the LGPS. LGPS pension funds are in themselves risk management tools, managing the risk that future employer income streams will be able to meet future pensions liabilities by creating a reserve from which future liabilities will be met.

5.5.2 Good governance is essential to ensuring that risks are identified and managed.

5.6 **Equalities and Diversity**

5.6.1 There are no Equalities and Diversity issues arising from this report.

5.6.2 Pursuant to the Equality Act 2010, the Council is under an obligation to have due regard to 1) eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; 2) advancing equality of opportunity between persons who share a relevant ‘protected characteristic’ and those who do not share it; and 3) fostering good relations between persons who share a relevant ‘protected characteristic’ and persons who do not share it. The ‘protected characteristics’ are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation. The Council also has regard to the additional protected characteristic of marriage and civil partnership even though this does not apply to parts 2) and 3) (above) of the public-sector equality duty.

5.6.2 The rules governing admission to and participation in the Pension Fund are in keeping with the public-sector equality duty. The Public Sector Equality Duty requires public authorities in carrying out their functions, to have due regard to the need to achieve the objectives set out under s149 of the Equality Act 2010. Good governance arrangements and monitoring of the Pension Fund's managers will benefit everyone who contributes to the fund.

5.7 **Corporate Parenting**

5.7.1 N/A

5.8 **Consultation and Engagement**

5.8.1 LCIV have engaged widely with London Boroughs on the need for the proposed changes.

5.9 **Insight**

5.9.1 N/A.

6. ENVIRONMENTAL IMPACT

6.1 There are no environmental implications arising from this report, although London CIV funds do facilitate investments to respond to climate risk and responsible investment more generally.

7. BACKGROUND PAPERS

7.1 None.