

Meeting	Pension Fund Committee
Date	18 March 2014
Subject	Update Report on London Collective Investment Vehicle
Report of	Chief Operating Officer
Summary	<p>This report updates the Pension Fund Committee on further work done to develop a robust business case and formal proposal to inform decisions for implementation of a London LGPS Collective Investment Vehicle (CIV), in the form of a UK based, Financial Conduct Authority (FCA) Authorised Contractual Scheme (ACS), recommends the Pension Fund Committee to participate in the establishment of the London wide collective investment vehicle and to contribute towards funding up to £25k from the Pension Fund towards the legal and set up costs of the collective investment vehicle.</p>

Officer Contributors	John Hooton, Deputy Chief Operating Officer Iain Millar, Head of Treasury
Status (public or exempt)	Public
Wards Affected	Not Applicable
Key Decision	Not Applicable
Reason for urgency / exemption from call-in	Not Applicable
Function of	Council
Enclosures	None
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1. RECOMMENDATIONS

- 1.1 That the Pension Fund Committee note the London Councils Leaders Committee' endorsement of the business case and formal proposals for the implementation of a London LGPS Collective Investment Vehicle (CIV), in the form of a UK based, Financial Conduct Authority (FCA) Authorised Contractual Scheme (ACS).**
- 1.2 That the Pension Fund Committee authorises the Chief Operating Officer to confirm the Pension Fund's interest in participating in the CIV and to carry out further due diligence on the establishment of a CIV including contributing up to £25,000 to be met from the Pension Fund towards legal and setting up costs.**

2. RELEVANT PREVIOUS DECISIONS

- 2.1 On 9th September 2013, (Item10) Pension Fund Committee expressed an interest in exploring the options for collaborative working including, subject to agreement to the business case, participation in a London wide collaborative investment vehicle (CIV). The Committee sought further information and requested that Officers bring an update report back to PFC in March 2014.
- 2.2 London Council Leaders Committee, 11 February 2014, (Decision item 6) endorsed the business case and formal proposals for implementation of a London LGPS Collective Investment Vehicle (CIV), in the form of a UK based, Financial Conduct Authority (FCA) Authorised Contractual Scheme (ACS) .

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

- 3.1 To ensure that the pension fund is being invested prudently and to the best advantage in order to achieve the required funding level. Participating in collective working and cost sharing will provide support towards the Council's corporate priorities.

4. RISK MANAGEMENT ISSUES

- 4.1 There is a risk that the Government may change the Local Government Pension Scheme (LGPS) regulations to force through pension fund mergers for administration, investment and governance. By participating in a collaborative project the Council may retain autonomy over its Pension Fund and benefit from reduced procurement costs and reduced investment management fees

5. EQUALITIES AND DIVERSITY ISSUES

- 5.1 Pursuant to the Equalities Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and 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.

- 5.2 The rules governing admission to and participation in the Pension Fund are in keeping with this public sector equality duty. Good governance arrangements and monitoring of the pension fund managers will benefit everyone who contributes to the Fund.

6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)

- 6.1 In recent months there has been some discussion on whether there should be consolidation or merger of Local Government Pension Funds into a smaller number of funds and whether this would lead to cost reduction and better investment return. The Government is currently consulting on some form of the consolidation of the LGPS, either on a voluntary or forced basis.
- 6.2 There is some evidence that the economies of scale associated with larger funds could lead to lower unit costs in relation to administration and actuarial advice for example. The position on investment performance is much less clear. There is no correlation between fund size and investment return. Investment returns are driven primarily by strategic asset allocation. Relative performance by asset class is linked to manager selection. Consequently there are both large and small funds whose performance is either below or above average.
- 6.3 To date collaboration has focused on administrative functions rather than on investment activity, the national procurement framework being one example. While a merger on a forced basis would not be in the Council's financial interest, it is clear that the status quo is not viable. London Councils and the Society of London Treasurers are exploring an alternative method for collaboration for between London pension funds in the form of a collective investment vehicle (CIV).
- 6.4 London Councils have commissioned expert legal and financial services advisors through the Pensions Working Group (PWG) to develop a robust business case and formal proposal to inform decisions for implementation of a London LGPS Collective Investment Vehicle (CIV) The PWG asked Leaders' Committee to recommend to the boroughs that they proceed to establish an Authorised Contractual Scheme (ACS) and the ACS Operator (the company that would manage the ACS) .
- 6.5 Previous work undertaken by PwC estimated savings in the region of £120m per annum from the creation of a CIV (the ACS), provided there was close to full participation by the 33 London local authorities. These benefits arose from reduced investment management fees, and improved performance.
- 6.6 More work has now been undertaken on potential costs and benefits, based on high level assumptions. Based on the expected savings previously identified, forecast costs should be comfortably covered by savings in reduced management fees. Even at a level of assets under management of £5bn, the expected savings materially outweigh the expected costs. The actual savings

and costs will naturally depend on the number of participating boroughs, amount of assets under management and the mix of investments that are selected for the ACS. It is expected that additional work to decide on new investment managers and to agree costs will begin in the 4th quarter 2014 in order that boroughs can make investment decisions in 1st quarter 2015

- 6.7 Boroughs would need to nominate to a new joint committee with a shadow board of directors. The proposed structure is that the boroughs would own all the share capital of the ACS Operator. Initially this would require minimal share capital (£1 per borough) but this capital requirement would increase once the operator was authorised and investments were made in the ACS. By making the £1 initial investment boroughs are showing a commitment to work together, not a commitment to invest together.
- 6.8 In the proposed structure a borough could choose to make investments that were either focused on a mixture of return and broader benefit, or clearly much more on investment return .
- 6.9 Each Pension Fund Committee could choose whether or not to use a fund manager from the CIV. It could for example retain its current managers or use a hybrid model retaining its own managers and use the CIV to diversify into alternative asset classes such as infrastructure and property and achieve economies of scale through the CIV that would not otherwise be possible for a smaller fund.
- 6.10 The costs of setting up the CIV would be recoverable from participating boroughs. The initial set up costs would include legal fees and other professional costs. Participating funds have contributed to these costs which are currently estimated to be a maximum of £25,000 per fund. It is anticipated that the contribution costs will be offset by the potential reduction in future investment management fees achievable through the CIV.
- 6.11 While there are considerable benefits from participating in a CIV in terms of the potential for cost –saving and resource pooling, there will be a perception of loss of control and autonomy at a borough level. Each fund would retain its own custodian's, control over asset allocation and accounting responsibilities although manager related information would be supplied by the CIV.
- 6.12 It should be noted that there is no obligation for any boroughs to commit to any additional funding of costs. To the extent a borough takes a subsequent decision to invest in the ACS, it is proposed the borough would at that point invest further capital.
- 6.13 The main advantage to the Barnet Pension Fund in joining the CIV is faster access to a wider variety of asset classes with low costs of entry and reduced management fees – without the need for a lengthy and costly procurement process and the opportunity to peer review potential managers in advance of committing funds or moving funds between managers.

- 6.15 The Pension Fund Committee is recommended to confirm its interest in participating in the CIV and in contributing to the set-up costs. All related costs including the initial £25k set up cost, will be met from the Pension Fund.

7. LEGAL ISSUES

- 7.1 This report is based on the provisions of this report is based on the provisions of Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009) which have their basis in the Superannuation Act 1972
- 7.2 Other statutory provisions are referred to in the body of this report.

8. CONSTITUTIONAL POWERS

- 8.1 Constitution – Part 3 Responsibility for Functions – Section 3 – Responsibility for Council Functions delegated to the Pension Fund Committee, through the Pension Fund Governance Compliance Statement.

9 BACKGROUND INFORMATION

- 9.1 In 2012, London Council's Leaders Committee considered a report from PwC which set out options for reconfiguring the London LGPS funds, and indicated the possible financial benefits of a CIV. Since then, the matter has been discussed several times, and it was agreed that further consideration should be given to creating a CIV, and that the most appropriate structure for the CIV would be an ACS. To date 25 local authorities have agreed to contribute £25-£50k towards exploring the proposal to be held in a designated fund by London Councils. These contributions will fund the professional costs associated with development of the proposed ACS and its Operator.

10. LIST OF BACKGROUND PAPERS

- 10.1 http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=4796
13 November 2012, Leaders' Committee report:
- 10.2 http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5072
11 December 2012, Leaders' Committee report:
- 10.3 http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5109
14 May 2013, Leaders' Committee report:
- 10.4 http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5252
19 September 2013, Executive report:
- 10.5 http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5353
26 November 2013, Executive report:
- 10.6 http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5490
10 December 2013, Leaders' Committee report
- 10.7 http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5495 11
February 2014, Leaders' Committee report

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