

REPORT FOR: PENSION FUND COMMITTEE

Date of Meeting:

29 July 2014

Subject:

London Pensions Collective Investment Vehicle

Responsible Officer:

Simon George, Director of Finance and Assurance

Exempt:

No.

Wards affected:

All

Enclosures:

Annex 1 - London Pensions Collective Investment Vehicle: Report to Pension Fund Committee on 19 March 2014

Annex 2 – Local Government Pension Scheme - Opportunities for collaboration, cost savings and efficiencies: DCLG Consultation

Section 1 – Summary and Recommendations

The report sets out the latest developments in the establishment of a Collective Investment Vehicle (CIV) to be available for London boroughs' pension funds to access should they wish. It also advises the Committee of the latest consultation being carried out by the Department of Communities and Local Government (DCLG) and the importance of the CIV concept in this consultation. It seeks the Committee's agreement to request that the Council resolves that Harrow becomes a shareholder in the company to be charged with setting up and managing the Vehicle and to a contribution of £25,000 towards the set-up costs of the CIV.

NB The acronym CIV is used variously to mean "Collective Investment Vehicle," "Collaborative Investment Vehicle" and "Common Investment Vehicle." In this report these terms are used interchangeably but with the same meaning.

Recommendations:

The Committee is invited to recommend to the Council that it resolves to:

1. become a shareholder in a private company limited by shares which will be incorporated to be the Authorised Contractual Scheme Operator (the “ACS Operator”) of the Collective Investment Vehicle;
2. contribute £1 to the ACS Operator as initial capital;
3. delegate to the Chairman of the Pension Fund Committee authority to act for the Council in exercising its rights as a shareholder of the ACS Operator and to authorise the Deputy Chairman of the Pension Fund Committee to act in his absence and;
4. agree to join the London Boroughs’ “Pensions CIV Joint Committee” to be formed under Section 102 of the Local Government Act 1972 and to delegate to such Joint Committee those functions necessary for the proper functioning of the ACS Operator, including the effective oversight of the ACS Operator and the appointment of Directors.

Subject to the Council agreeing the above recommendations, the Committee is asked to authorise the Director of Finance and Assurance to consider any requests for additional capital and, if he assesses that a capital commitment is likely to be beneficial to the Pension Fund, to seek agreement from the Committee

Also subject to the Council agreeing the above recommendations, the Committee is asked to agree to contribute £25,000 to be used to commission specialist expert professional advice associated with the development of the proposed CIV.

Section 2 – Report

Introduction

1. On 19 March 2014 the Committee considered the report as attached as the annex to this report and their discussion was minuted as follows:
 - The Committee received the report of the Director of Finance and Assurance which set out developments in the establishment of a Collective Investment Vehicle (CIV) for London boroughs, and which proposed that the Committee recommend to Council that the Council become a shareholder in the management company.
 - Members considered the benefits of joining at the outset, given that the initial financial commitment was small and further contributions could be decided later, against the advantages of monitoring the situation until the membership and direction of the CIV became clear, and the

potential outcomes and benefit to Harrow could be more realistically assessed.

- Members discussed the structure and governance of the CIV, and the role of borough Leaders, elected members, and expert advisers in determining its management, strategy and direction. A Member expressed the view that Harrow would have more influence in shaping the future of the CIV as a member on the inside than as an observer on the outside. The Chair commented that the decision on joining should be left until after the election, given the scope for change in the composition and focus of all the London boroughs. The Committee noted that the initial deadline for requesting membership was before the next Council meeting at which any recommendation could be ratified.
 - The officer stated that 25 boroughs had contributed towards the cost of developing the CIV, and it was felt by some of these that membership of the CIV offered some protection against possible, future changes to the Local Government Pension Scheme (LGPS).
 - Members were clear that their priority was to achieve the best possible outcome for Harrow's Pension Fund, and they agreed that they had insufficient information before them at this stage to be confident that early membership would secure this. They wanted clarity on costs, tax liability, and the degree to which constituent members could be selective in their levels of investment. They agreed to defer the decision until the next meeting, when they hoped that the Director of Finance and Assurance would be available to answer questions and provide further information.
 - **RESOLVED:** That the decision on joining the Collective Investment Vehicle for London boroughs be deferred until the next meeting of the Committee.
2. Whilst Council officers have attended a number of meetings and briefings where the CIV has been discussed and have provided information about the Harrow Fund's manager structure, they have not played a leading role and have relied on briefings to remain up-to-date. They understand that the latest position on progress was stated in a report to London Councils Leaders' Committee on 15 July. Their main points from that report are summarised as "Current Position" in paragraphs 3 to 16 below.

Current position

Borough engagement

3. At their meeting in February 2014 the London Councils Leaders' Committee recommended to each local authority which decides to participate, that they resolve a number of recommendations necessary to the establishment of the CIV. Since then 24 boroughs have given formal notification (in the form of a letter to the London Councils Chief Executive) that such resolutions have been made, five more are expected to give notification shortly and four have decided that they will not be participating at this time.

4. Twenty eight boroughs have agreed to contribute £25,000 each to the fund (£700,000 in total), another is likely to contribute shortly, and four have decided not to participate at this time. The fund is being used to commission specialist expert professional advice associated with the development of the proposed CIV. At this point £470,000 of the fund has been committed to cover the costs of expert advisors, Eversheds, Deloitte, Northern Trust and Mercer, and the engagement of a Programme Manager on a one year fixed-term contract.

Governance and structures

5. The CIV is being developed for and on behalf of the London boroughs, and the boroughs will participate on an entirely voluntary basis. As such, considerable attention has been given to ensuring that the proposed governance and operational structures of the CIV reflects the wishes and needs of the boroughs, both on day one and into the future.
6. From advice to date the governance and structures described below are considered to give sufficient ownership and control for the participating boroughs that the CIV can be treated as if it is a department of each borough (procurement professionals would recognise this as being “Teckal compliant”). As such, there is no requirement for a borough to procure either the services of the Operator or entry in the Fund.
7. A key element of the governance structures is a new Sectoral Joint Committee (the “Pensions CIV Joint Committee”). This committee will act as a representative body, made up of elected members, for those local authorities that resolve to participate in the arrangements. At its March 2014 meeting, Leaders’ Committee agreed, in principle, the Pensions CIV Joint Committee terms of reference. London Councils will shortly approach participating boroughs for nominations to this committee.
8. The CIV will be a Financial Conduct Authority (FCA) regulated UK domiciled Authorised Contractual Scheme (ACS). There are a number of separately regulated elements to the structure, including an ACS Operator and the ACS Fund.
9. The ACS Operator is a limited liability company, which will be wholly owned by the participating boroughs. It will initially have interim directors, as proposed in the February report to Leaders’ Committee, with final directors appointed later, ahead of the Operator becoming operational.
10. Action is currently in hand to incorporate the company, which includes:
 - Each participating borough completing a “shareholder details” form and agreeing model Articles of Association (which will be tailored later to reflect the company’s final operating model);
 - Each of the agreed interim directors submitting a “director details” form and agreeing the model Articles of Association.
11. It is anticipated that, initially, the Operator will be based on an outsourced model. As such it will have a limited number of directly employed staff, with most functions being provided through outsourced partners. Over time, it is likely that a number of the outsourced functions could be brought

in-house, but this will depend on establishing the necessary level of skills, knowledge and expertise, either through recruitment or training.

12. Procuring the outsourced partners is a complex and time consuming exercise and the Technical Sub-Group (of London Councils Pensions Working Group) have begun the process of drawing up specifications and engaging with the market. It is hoped to have the key partners in place by the autumn.

Structuring the ACS fund

13. Final decisions about the initial fund structure will be taken later in the year, following consultation with the participating boroughs and the Investment Management industry. However, it is thought that a pragmatic starting point is to analyse which Investment Managers (IM) boroughs are currently invested through, to look for commonality (i.e. more than one borough invested with the same IM in an identical mandate), and to discuss with boroughs and IMs which mandates would be most appropriate to transition to the ACS fund for 'day-one'. Each mandate would become a separate, ring-fenced, sub-fund within the overall ACS fund.
14. Over time the ACS fund will evolve and develop, with the potential for some mandates to be removed and others to be brought on. The Operator will not be regulated to give investment advice to the boroughs (at least not initially), and so thought is being given to the governance structures that might inform decision making of the boroughs and ensure that the boroughs needs and wishes are reflected in the ACS fund going forward. Current thinking is that an investment committee might be formed, with a number of LGPS experts drawn from across the boroughs and, potentially, some independent experts. This committee would meet to consider how the ACS fund is performing and how it might be developed. Those considerations would be informed by input from a panel of procured investment advisors. Reports and recommendations would flow from the investment committee to the Pensions CIV Joint Committee (PCJC) (similar to the way borough officers and investment advisors support borough pension committees). The PCJC would consider the recommendations made by the Investment Committee and feed its recommendations to the Operator. The Operator will act on the recommendations of the PCJC, subject to the necessary due diligence checks and so on, that it will be required to carry out as the regulated body with responsibility for the good management of the ACS fund.

Next steps

15. There are a number of complex dependencies that impact on the detailed project plan, and some of these have yet to be resolved. However, it remains the intention that the ACS fund will be established and operational in the spring of 2015.
16. Key next steps include:
 - Now
 - Incorporate the Operator as quickly as possible;

- Commence the procurement of outsourced partners (legal advice is that the Operator will be required to follow EU procurement rules);
- By the autumn:
 - Finalise contracts with key outsourced partners;
 - Finalise issues connected to the wider LGPS;
 - Settle decisions connected to the ACS fund structure for launch;
 - Seek decisions from participating boroughs about the expected extent of investment into the ACS fund at launch;
 - Recruit (final) directors for the Operator to replace the interim directors that are being appointed now – this is likely to require the engagement of a specialist recruitment consultant;
 - Engage staff in the Operator, and settle an SLA with London Councils
- Before Christmas:
 - Approach the FCA for authorisation of the Operator and ACS fund;

Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies – DCLG Consultation

17. Attached as Annex II is the consultation document published by the DCLG arising from their call for evidence on the future structure of the Local Government Pension Scheme and their wish to identify opportunities to reduce administration and investment management costs.
18. The consultation period ran from 1 May until 11 July. DCLG advises that it drew on three sources of evidence:
 - A call for evidence on the future structure of the Local Government Pension Scheme, which ran from 21 June to 27 September 2013; 133 responses were received and analysed, helping to inform the consultation
 - An analysis of the responses to the call for evidence provided by the Shadow Scheme Advisory Board
 - Supplementary cost-benefits analysis of proposals for reform commissioned from Hymans Robertson.
19. In paragraph 3.1 of the consultation document the Government have put together proposals which “balance the opportunities from aggregation and scale whilst maintaining local accountability.” Some of these proposals are stated in paragraph 3.2 as follows:
 - Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs
 - Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market
 - Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme

- A proposal not to pursue fund mergers at this time
20. In paragraph 3.15 the Government say that “this consultation focuses on the cost savings to be found through collaboration and more efficient investment.”
21. Having considered the various responses and the Hymans Robertson’s analysis, in paragraph 3.31 the Government appears to be focussing its attention primarily on “achieving economies of scale through the use of common investment vehicles.”
22. In paragraphs 4.1 to 4.11 the Government makes the case for common investment vehicles and three of their five consultation questions relate to them as follows:
- Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.
- Q2 Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?
- Q3 How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles
- Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?
- Q5. In the light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson’s evidence on aggregate performance, which of the options set out above [paragraph 4.30 of the consultation document] offers best value for taxpayers, Scheme members and employers?
23. With consultations of this type it would be appropriate for the Committee to be invited to agree responses but for two main reasons no response is recommended:
- The Committee did not meet during the consultation period
 - The current views of the Committee on common investment vehicles are such that answers to Q1, Q3 and Q4 would be difficult to construct
24. In view of the second point above officers did not feel able to send a response “subject to Committee” ratification though they would have felt reasonably confident in answering Q2 and Q5 as follows:
- Q2. Yes – with explanatory comments covering the benefits of local decision making

Q5. Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper [the consultation document] and the Hymans Robertson report.

25. Whilst the LGPS consultation document is not, in itself, a reason for the Committee to agree to the recommendations in this report it is, perhaps, an indication that the Government is giving some credibility to the CIV concept and may provide an ancillary reason to join the London CIV.

Financial Implications

26. A reduction in administration and investment management costs would be a contributory factor to the overall well being of the Pension Fund.

Risk Management Implications

27. Risk included on Directorate risk register? No

28. Separate risk register in place? No but risks are extensively discussed in the Pension Fund Statement of Investment Principles and Annual Report

Equalities implications

8. Was an Equality Impact Assessment carried out? Yes

9. There are no direct equalities implications arising from this report.

Council Priorities

10. Administration and investment management costs have a direct impact on the financial health of the Pension Fund which directly affects the level of employer contribution which, in turn, affects the resources available for the Council's priorities.

Section 3 - Statutory Officer Clearance

Name Simon George	<input type="checkbox"/>	Director of Finance and Assurance
Date: 17 July 2014		
Name: Caroline Eccles	<input checked="" type="checkbox"/>	on behalf of the Monitoring Officer
Date: 17 July 2014		

Ward Councillors notified:

NO

Section 4 - Contact Details and Background Papers

Contact: Ian Talbot, Treasury and Pension Fund Manager 0208 424 1450