

PENSIONS INVESTMENT COMMITTEE			
REPORT TITLE	London LGPS Collective Investment Vehicle		
KEY DECISION	No	Item No:	8
WARD	N/A		
CONTRIBUTORS	Executive Director for Resources & Regeneration		
CLASS	Part 1	Date:	26 th June 2014

1. SUMMARY

- 1.1 This report provides members with a summary of the presentation made by the Pensions Working Group (PWG) to the London Council's leader committee on 11th February 2014 with respect to establishing a London Local Government Pension Scheme (LGPS) Collective Investment Vehicle (CIV). The presentation consisted of a business case and formal proposal to inform decisions for implementation of a London LGPS CIV, in the form of a UK based, Financial Conduct Authority (FCA) Authorised Contractual Scheme (ACS).
- 1.2 The Pension Investment Committee will need to approve membership of the ACS and will be asked to approve a contribution of £25,000 towards the set up costs of the ACS and operator, and an initial shareholder investment of £1 at this stage to register an interest in participating. There is no further obligation to participate or invest at this stage.

2. RECOMMENDATION

2.1 The Committee is recommended to:

- (1) Agree in principle to join in the formation of the Collective Investment Vehicle,
- (2) Seek approval of Mayor and Cabinet, and Full Council to:
 - A. Become a shareholder in the ACS Operator,
 - B. Agree to appoint an elected Councillor who will have power to act for the local authority in exercising its rights as a shareholder of the ACS Operator, and
 - C. Agree that that Councillors from the London Boroughs are appointed as interim directors of the ACS Operator, subject to the consent of their relevant authorities to the appointments. These directors may be replaced once FCA authorisation is formally applied for.

Subject to section (2) above:

- (3) Agree in principle that the fund invests £1 to the ACS Operator as initial shareholder capital, and
- (4) Agree in principle to contribute £25,000 towards the establishment of the ACS.

3. BACKGROUND

- 3.1 In June 2013, the Government issued a call for evidence on the future structure of the LGPS, and sought professional advice to consider either Collective Investment Vehicles or merger of funds as potential routes forward.
- 3.2 According to Hymans Robertson; 'A CIV invests the capital supplied by its investors to produce an investment return. The subscribed capital is supplied by investors either as monetary amounts or by transferring existing assets into the vehicle. The CIV can be set up as a single pool of assets (including multiple asset categories) or as an umbrella arrangement which includes a number of sub-funds, each of which is usually specific to a particular asset class.'
- 3.3 The aim of setting up a CIV for London is to achieve similar financial gains to a merger, but without the disadvantages, such as loss of governance, and control.
- 3.4 London Councils Leaders committee set up a small member/officer group, the Pensions Working Group (PWG), to work with London Councils to take forward further exploration of options for greater collaboration across London's 34 Pension Funds. In February 2014, the PWG presented to the Leaders Committee a progress report and business case for the next steps of a London LGPS CIV.
- 3.5 It was agreed at the meeting for the committee to recommend to each local authority which decided to participate that they resolve to agree:
 - 3.5.1 (A) a private company limited by shares be incorporated to be the Authorised Contractual Scheme Operator (the "ACS Operator"), structured and governed as outlined in this report, and that the local authority agrees :–
 - (i) to become a shareholder in the ACS Operator,
 - (ii) to contribute £1 to the ACS Operator as initial capital,
 - (iii) to appoint an elected Councillor who will have power to act for the local authority in exercising its rights as a shareholder of the ACS Operator, and
 - (iv) that Councillors from the London Boroughs are appointed as interim directors of the ACS Operator, subject to the consent of their relevant authorities to the appointments. These directors may be replaced once FCA authorisation is formally applied for.
 - 3.5.2 (B) a representative body, in the form of a new sectoral joint committee (the "Pensions CIV Joint Committee"), is established (pursuant to the existing London Councils Governing Agreement, dated 13 December 2001 (as amended)) to act as a representative body for those local authorities that resolve, in accordance with

- 2(a) above, to participate in the Arrangement (or in the alternative, should all 33 London authorities resolve to participate, that Leaders' Committee exercise these functions and the Governing Agreement be varied accordingly).
- 3.5.3 (C) All London local authorities respond in writing to the London Councils Chief Executive, by 14 April 2014, or before the day of the local government elections (22 May 2014), to advise of their decisions regarding the matters set out at paragraphs 3.6.1 and 3.6.2 above.
- 3.6 Lewisham has not yet responded in writing to the London Councils Chief Executive.
- 3.7 A number of the local authorities agreed to contribute £25-£50k towards exploring the proposal. This money is held in a designated fund by London Councils. Lewisham has yet to agree whether to make a contribution. These contributions will fund the professional costs associated with development of the proposed Authorised Contractual Scheme (ACS) and its Operator.
- 3.8 A copy of the full report can be found on the following link:
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5562
- 4. MAIN POINTS FROM THE PENSIONS WORKING GROUP PRESENTATION**
- 4.1 It was previously agreed that the most appropriate structure for the CIV is an ACS fund. The ACS will require an FCA regulated ACS Operator to be established. The board of directors and employees of this company will have overall responsibility for the operation of the ACS.
- 4.2 In broad terms, the proposed structure is that the participating boroughs will own all the share capital of the ACS Operator. Initially this will require minimal share capital (£1 per borough from those who wish to participate) but this capital requirement increase once the operator is authorised and investments are made in the ACS.
- 4.3 A new 'Pensions CIV Joint Committee' will be established to assist in the appointment of key directors of the ACS Operator, such as the Chairman and Chief Executive Officer. The Pensions CIV Joint Committee will comprise elected Councillors nominated by participating boroughs. Information will be provided regularly by the ACS Operator to investors in the ACS and borough Pension Committees and officers, and the Pensions CIV Joint Committee.
- 4.4 The exact mandate of the joint committee will require further consideration. The frequency of meetings of the joint committee also needs to be decided. It is proposed that up to three elected Councillors from the Pensions CIV Joint Committee could be directors of the ACS Operator. The directors have to be approved by the FCA and will have fiduciary duties and responsibilities. The decision as to who could be in these roles is to be decided.
- 4.5 The ACS is expected to be launched in February 2015. The proposed timetable for launch can be found in Appendix A.
- 4.6 At the National Association of Pension Funds (NAPF) Local Authority Conference in May 2014, DCLG minister Brandon Lewis told the conference that the

government is keen to learn from local authorities that have achieved value in their funds.

Financial benefits

4.7 The 33 London boroughs currently have over £20bn of pension assets under management. Previous work undertaken by PwC estimated savings in the region of £120m per annum from the creation of a CIV, provided there was close to full participation by authorities. Costs of running the ACS were estimated to be between 1 and 5 basis points (0.01% to 0.05%) of assets under management with the estimated costs, for full participation from all 33 London local authorities, estimated to be £4.8m per annum. At lower levels of participation, both the financial benefits and the costs would reduce.

4.8 Indicative costs and potential savings are set out in the table below, for assets under management of £24bn, £10bn, and the minimum target size of £5bn.

4.9 For Lewisham, with a largely passive fund the savings will likely be in the respect of management fees rather than in improved performance.

4.10 Summary of potential savings and costs

	Assets under management	Assets under management	Assets under management
	£24bn	£10bn	£5bn
	£ 000's	£000's	£ 000's
Expected savings per annum(1)			
Investment management fees - 15 bps	36,000	15,000	7,500
Improved performance - 35 bps	84,000	35,000	17,500
Total expected savings	120,000	50,000	25,000
On-going Costs per annum(2)			
Custody costs	(8,400)	(4,000)	(2,500)
Custody costs (at 3.5bp, 4bp and 5bp)			
<i>Incurring in existing third party funds (3)</i>	3,600	1,500	750
Net Custody Cost	(4,800)	(2,500)	(1,750)
Other Costs			
Salaries –e.g. COO/Admin	(400)	(400)	(400)
- Audit/advice	(200)	(150)	(100)
- Offices/expenses	(200)	(200)	(200)
- Misc. Advisory	(500)	(400)	(300)
Total On-going Costs	(6,100)	(3,650)	(2,750)
Establishment costs (2)(3)			
- Transition advisory including custody selection	(700)	(500)	(400)
- Other misc. fund advisory	(500)	(500)	(500)
- Legal, regulatory, and financial advice (funded already)	(600)	(600)	(600)
Total Establishment Costs	(1,700)	(1,500)	(1,400)

Custody costs

- 4.11 The main cost associated with running the ACS is from the custody of the assets. Custody costs are calculated as a basis point fee on the amount of assets, with the basis point fee reducing on a sliding scale as the amount of assets under custody increases.
- 4.12 In relation to existing segregated mandates, it is likely that savings would be achieved through moving such mandates to an ACS as this would reduce custody costs. This is because most existing segregated mandates are relatively small and accordingly consolidating these mandates in the ACS should increase the amount invested in each mandate which in turn would result in a lower basis point custody charge.

Other costs and benefits

- 4.13 Other on-going costs of the ACS are likely to include staff costs, FCA fees, consultancy fees and administration costs including audit and taxation. These fees would be charged directly to the fund, as they would be now. Consultancy fees might include professional advice on investment manager selection. As this would be performed centrally at the ACS level rather than multiple times at individual borough level, it is likely that savings would be achieved in this regard. Admin costs would not be expected to be significant compared to the benefits identified.

Establishment costs

- 4.14 There will be a number of establishment costs incurred in setting up the fund. These will be one-off costs in the first year. £625,000 has already been contributed to these costs by the boroughs, in order to engage professional advisors to perform the necessary financial and regulatory work. It is currently expected that this work will be performed within this existing budget.
- 4.15 As the project progresses, additional professional fees are likely to be incurred. For example, to assist in training relevant individuals on their regulatory roles and to assist in the development of procedure manuals. It will become clearer in due course where costs may arise in this regard.
- 4.16 The transition of assets into the fund will also need to be considered, as assets are moved from existing managers to new managers appointed to the ACS. To a large extent, boroughs already incur similar costs as they transition assets to different managers in the ordinary course of their pension activities. As such these costs may well simply offset existing costs incurred by boroughs although clearly this depends on the level of fees currently charged and the number of transitions.

5. FINANCIAL IMPLICATIONS

- 5.1 So far 28 boroughs have said that they agree with the principle and that they are willing to pay £25,000 to pay for implementation measures. Lewisham would also make a contribution of £25,000, and the £1 initial share capital. Other than these costs, there are no immediate financial implications from accepting the recommendations of this report. The council will still have its existing freedoms and obligations to invest its pension fund assets as it considers most appropriate, whether via the CIV proposed in this report or elsewhere.

- 5.2 However, there are good grounds for believing that the CIV will be able to deliver small reductions to fund managers' fees and hence that, over time, it will prove an attractive option in which to invest and deliver better net investment returns.

6. LEGAL IMPLICATIONS

- 6.1. London Councils are taking external expert legal advice upon the relevant powers for London Councils to participate in a London LGPS Collective Investment Vehicle (CIV) and on the appropriate structure and governance arrangements for the ACS Operator to ensure compliance with each Administering Authority's Statutory duties in relation to the Fund . Any decision to enter into such an arrangement and the checks and balances which will be required to protect the Fund will be considered in the light of such advice.
- 6.2. The ACS will be subject to the regulatory control of the Financial Conduct Authority.
- 6.3. If the Council does determine to invest in the CIV, then such investment will be subject to the Council's published Statement of Investment Principles, (which itself will need amending to reflect the establishment of the CIV) and the relevant investment thresholds prescribed in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, as amended which set limits on the percentage of the fund which can be invested in different types of investment.

7. CRIME AND DISORDER IMPLICATIONS

- 7.1 There are no crime and disorder implications directly arising from this report.

8. EQUALITIES IMPLICATIONS

- 8.1 There are no equalities implications directly arising from this report.

9. ENVIRONMENTAL IMPLICATIONS

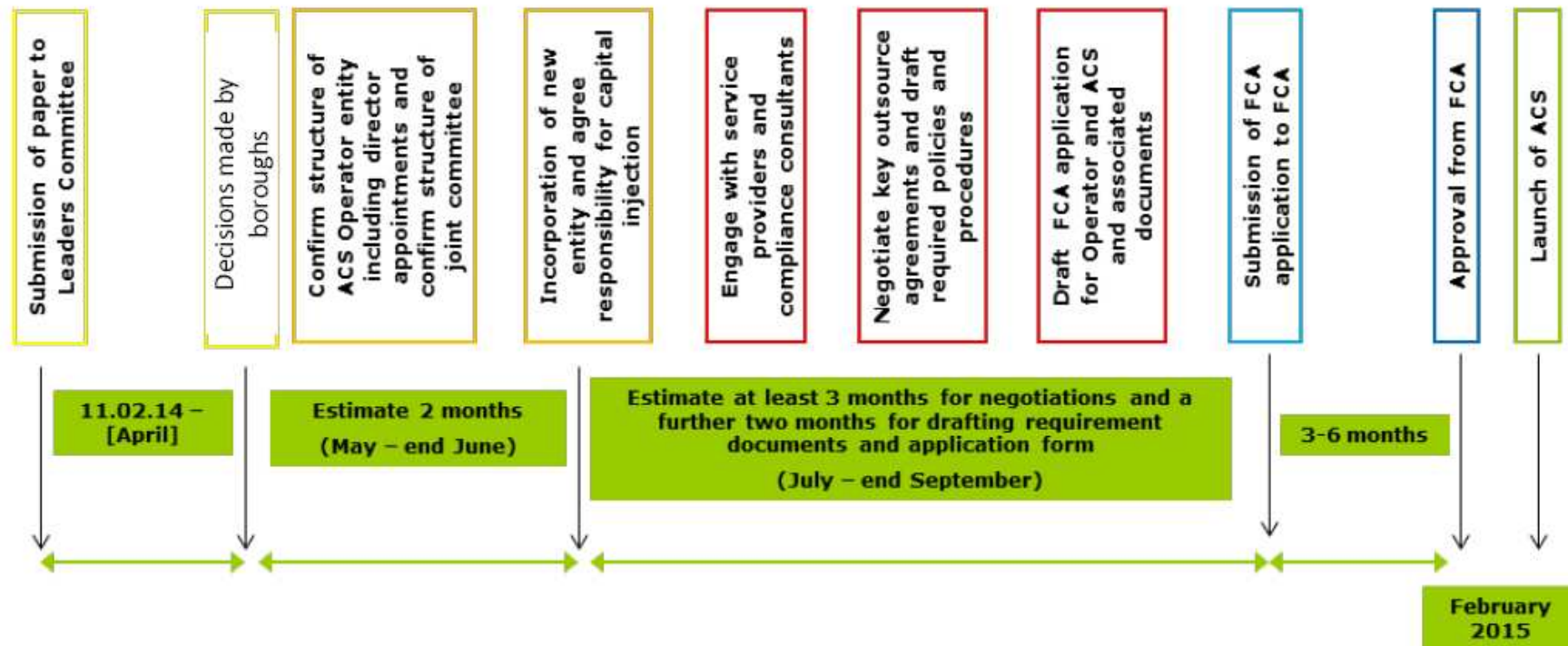
- 9.1 There are no environmental implications directly arising from this report.

FURTHER INFORMATION

If there are any queries on this report or you require further information, please contact:

David Austin on 020 8314 9114, or Adeola Odeneye Principal Accountant
Strategic Finance on 020 8314 6147

Proposed timeline for launch of ACS and ACS Operator



Important note: The above timeline is an estimated timeline and assumes that there will be no undue delay in the project. We would suggest that 3 months prepare the FCA applications, to negotiate contracts and prepare documents is a minimum and this is more likely to take up to 6 months. The FCA can take up to 6 months to review the application for the ACS Operator (on the basis the application is complete) and usually an application for an ACS will not be considered by the FCA before the ACS Operator is approved however we would hope that the two applications can be run concurrently and that 6 months would be the maximum period for review, although this cannot be guaranteed.