



PENSIONS COMMITTEE 17 March 2015	REPORT
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Subject Heading:	Development of the Pension Collective Investment Vehicle
Report Author and contact details:	Contact: Debbie Ford Designation: Pension Fund Accountant Telephone: (01708) 432569 E-mail address: Debbie.ford@havering.gov.uk
Policy context:	Pensions Investment Strategy
Financial summary:	If the Council decides to join the CIV it will make an initial contribution of £1 in the share capital of the ACS and £75k contribution in set up and implementation costs.

SUMMARY

To update the Committee on the progress made in establishing a Collective Pensions Investment Vehicle (CIV) across London and of the opportunity for the Council to participate in its development.

The benefits of joining the CIV will come from potential fee reductions. Indications are that eleven separate managers may be brought into the CIV for launch, with an average reduction of 20% in fees per manager.

RECOMMENDATIONS

The Committee is asked to:

- a) note the progress made in establishing the creation of a CIV across London.
- b) Consider whether it wishes to recommend to Council that it seek membership of the CIV.

REPORT DETAIL

1. Background

- 1.1 On the 11 February 2014 the Leaders Committee of London Council's approved a report and the underlying business case supporting the creation of a Collective Investment Vehicle (CIV) across London.
- 1.2 A report was presented to the Pension Committee on the 26 March 2014 asking for the committee to comment and note the arrangements for the creation of a CIV and that at the Council meeting being held on the 26 Mar 2014 they would be recommended to join the CIV.
- 1.3 The Pensions Committee commented that they had concerns around the financial and governance arrangements and would not recommend joining the CIV until further information was available. This view was endorsed at the Council meeting.
- 1.4 Some progress in the development of the CIV has been made and this report outlines that progress.

2. Progress

- 2.1 The process of establishing the CIV has commenced and Interim Directors of the ACS Operator have been appointed.
- 2.2 An Implementation programme has been set up and includes three projects:
 - a) **Establish the company that will become the ACS operator** - includes all areas associated with setting up a new company, agreeing a licence to occupy within the same building as London Councils (59 ½ Southwark Street), and setting up finance, HR and IT systems and policies.
 - b) **Establishing the company as a financial services organisation regulated by the FCA** – includes defining the company's operating

model, writing policies and procedures, completing a significant amount of paperwork to support the authorisation application to the FCA, and procuring relationships with key partners such as the asset provider (covering custodian, depository and fund administration).

- c) **Establish the Fund for Launch** – analysing the current pattern of investments across the councils, engaging with the investment managers to gather detailed data about assets under management, mandate types and fee structures, discussing with the Investment Managers which mandates may be suitable to transition to the CIV, putting the proposed structure to each borough for consideration by the relevant committee and later agreeing a transition strategy for launch.
- 2.3 To support the delivery of this programme a Technical Sub-Group (TSG) was set up. This is made up of two officers from the London Councils and a number of LGPS experts from across the councils, under the leadership of the Director of Finance from LB Wandsworth.
- 2.4 The Leaders' Committee agreed to set up a new Joint Committee (The Pensions CIV Joint Committee). That committee has now been formed and met for the first time on the 17 December 2014. A copy of the first reports are attached as **Appendix A** and includes in more detail reports covering:
- a) Item 5 - Terms of Reference & notification of membership
 - b) Item 6 - Background and progress update (also covers governance & structures)
 - c) Item 7 – Fund Manager analysis update
 - d) Item 8 – Asset Servicer Procurement update
 - e) Item 9 – Dates of future meetings
- 2.5 So far 30 out of 33 London Boroughs have become active participants in the CIV. Each of those Councils has to date committed to contributing £25,000 into a designated fund. Those Councils already participating have been asked for a further £25,000 and another £25,000 will be requested at the start of the next financial year. Total joining cost at this stage is £75,000. Upon joining the CIV there will be a future financial commitment of contributing towards the on-going operating costs.
- 2.6 The designated fund is being used to commission specialist expert professional advice associated with the development of the proposed CIV. A key provider to the CIV will be as Asset Servicer (covering fund Administration, depository and custodian roles). This contract has now been awarded.
- 2.7 The TSG is currently undertaking analysis of the assets under management to identify commonality of investments across the London funds. The focus is on those fund managers which currently have mandates shared by two or more funds. More formal negotiations with fund managers are expected to start soon.

2.8 It is reported that it looks likely that the CIV will launch in the summer of 2015, but key to this will be defining the company's operating model and taking this to the FCA for authorisation.

3. Governance

3.1 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.

3.2 The governance principles adopted during the development of the proposed structure still stands:

a) Investment in the ACS should be voluntary. A borough should be able to decide they do not wish to participate, or to the extent they initially decided to participate, to choose to withdraw their investment.

b) If a borough chose to invest, it will be able to choose which asset classes to invest into, and how much they might invest into each asset class.

c) The boroughs should have sufficient control over the ACS Operator, in order to be assured that it will be acting in their best interests.

d) The ACS Operator would provide regular information to participating boroughs regarding the performance of managers, investment options, and other areas, so that information continues to be available to the same extent it is currently in order for boroughs to make investment decisions.

e) The ACS will not increase the overall investment risk faced by boroughs.

3.3 A key element to the governance structure is the structure of the Pension CIV joint committee. Boroughs investing in the ACS will also have membership of the Pensions CIV Joint Committee. This joint Committee will assist the boroughs having a shareholding in the ACS and will have the power to identify and appoint key directors to the ACS Operator. It will also be the forum to discuss key issues which affect the participating local authorities, both individually and collectively.

3.4 The pensions CIV Joint Committee will be fulfilling two roles:

a) To consider and provide guidance on the direction and performance of the CIV (Joint Committee meetings)

b) To take decisions on behalf of the participating local authorities in their capacity as shareholders (Shareholder meetings).

- 3.5 The CIV will be in the form of an authorised contractual scheme (ACS) and this will be a private company limited by shares (London LGPS CIV Ltd). The ACS will also be required to be regulated by the Financial Conduct Authority (FCA).
- 3.6 The ACS is wholly owned by the participating boroughs. At this stage it only has interim directors; Major Pipe, Councillors O'Neill and Dombey, Mr Chris Bilsland (Chamberlain, City of London), Mr Chris Buss (Finance Director, LB Wandsworth), Mr Ian Williams (Finance Director, LB Hackney), and Mr John O'Brien (Chief Executive, London Councils). Final directors to be appointed ahead of the company being authorised and operational.

4. Joining instructions

- 4.1 Local Authorities wishing to participate in the CIV will agree:
- 4.1.1 to become shareholders in the ACS Operator
 - 4.1.2 to contribute £1 to the ACS Operator as initial share capital
 - 4.1.3 to contribute £75,000 for the exploration and implementation costs. Upon joining the CIV there will be a future financial commitment of contributing towards the on-going operating costs
 - 4.1.4 Appoint an elected Councillor to act for the Local Authority in exercising its rights as a shareholder of the ACS Operator. (Most boroughs have nominated their pension committee chair or a member of the pensions committee).
 - 4.1.5 that Major Pipe, Councillors O'Neill and Dombey, Mr Chris Bilsland (Chamberlain, City of London), Mr Chris Buss (Finance Director, LB Wandsworth), Mr Ian Williams (Finance Director, LB Hackney), and Mr John O'Brien (Chief Executive, London Councils) be appointed as interim directors of the ACS Operator. Please note these appointments have already taken place.

If the Pensions Committee decides to recommend membership, a report will also be made to full Council with an update on the progress of the CIV with a request that Council reconsider whether the London Borough of Havering Pension Fund should now participate in the CIV.

The decision on whether to invest Pension Fund money into the CIV will be made by the Pensions Committee once the vehicle has been established and if there are investment funds into which the Havering Pension Fund can place its assets. A full assessment of options will be made at that time as to whether the investment into the CIV is appropriate for the Fund. This will include consideration of the returns available, cost reductions available and associated risks, in line with all other investment decisions that are made.

IMPLICATIONS AND RISKS

Financial Implications and risks:

If the Council decides to join the CIV it will be required to contribute £1 in initial share capital. However, further contributions will be required to meet the initial set up and implementation costs, currently set at £75,000. Based on the current participation of 30 boroughs this will raise £2,250,000. Included in the report attached at **Appendix A, Item 6**, estimated expenditure to launch the CIV is currently set at £1,733,831. Any underspend after launch will be used to contribute towards the first year's operating expenses as the CIV becomes established and the 'business as usual' budget and fee structure comes into play.

A 'business as usual budget' is currently being worked on by the Technical Support Group and will be reported to the Pensions CIV Sectoral Joint Committee at a later date. Regular contributions into the operational costs of the CIV will be necessary.

Initial financial implications presented to London Councils suggest that savings will be achieved in management fees. These are expected to outweigh the costs of administration and still produce a net gain for member authorities. Indications are that eleven separate managers may be brought into the CIV for launch; nine have provided estimates of fee savings, with an average reduction of 20% in fees per manager. The benefits of joining the CIV will come from potential fee reductions.

Whilst the Government is expected to support this form of partnership arrangement there remains a risk that it will produce alternative proposals to merge Local Authority Pension funds. This matter has been the subject of extensive consultation by the Government although there has been no indication the Government thinks that Councils should stop their plans to establish a CIV.

Kris Hopkins MP, Parliamentary Under Secretary of State for Communities and Local Government has met Major Pipe and Cllr Teresa O'Neill and officers from the TSG since the consultation and was very interested in the achievements through a voluntary and collaborative approach. It has been agreed that he will be updated with developments.

The risks of non-participation in this collaborative venture are seen as far more significant, particularly if the outcome were to be a merger of funds which could see decisions being taken by external bodies and resulting in loss of accountability and potential to increase costs to local taxpayers.

Any financial contributions to the establishment and operational costs of the CIV will be met by the Pension Fund.

Legal Implications and risks:

A decision to enter into the agreement for the ACS and to become a shareholder in the ACS operator company (which will be a company wholly owned by the member Councils) has limited legal implications for the Council as it gives the Council the opportunity to invest via the ACS, but not a legal commitment to do so. However it is clear that the intention is that members would make some use of the facility, and it is probable that it would be in the financial interest of the pension scheme to place some funds with the ACS, particularly if its size enables it to obtain better deals with active pension fund managers. However its existence will not absolve the pension committee from reviewing performance of the fund, it would switch from fund managers to the ACS. There will also be a need to ensure that there isn't a conflict of interest for whichever councillor is the Council's representative on the proposed joint committee, but that can be addressed when selection occurs.

The Report to the London Councils meeting of 17 December refers to legal advice obtained from solicitors and counsel. It appears also that further advice will be obtained from counsel to clarify certain matters. That may have been provided in the subsequent report of 11 Feb but as at the date of drafting these comments that Report is not available.

It is clear that there are a number of legal risks for the constituent Local Authorities when the CIV procures contractors/services through the ACS. The legal advice from London Councils' lawyers indicates that this risk is low, however, it is subject to the clarification mentioned above.

If the Pension committee is minded to recommend joining the CIV to Council it is hoped that some of the legal uncertainties will have been resolved, but these will be addressed more fully in the Report to Council. It is also possible that changes will be required to the Constitution.

Human Resources Implications and risks:

None arising directly

Equalities implications and risks:

None arising directly

BACKGROUND PAPERS

London Councils Leaders' Committee papers 11 February 2014

London Councils Pensions CIV Sectoral Joint Committee papers 17 December 2014