CABINET

23 September 2015

Subject Heading:	**Pensions Collective Investment Vehicle**
Cabinet Member:	**Clarence Barrett,** Cabinet Member for Financial Management
CMT Lead:	**Andrew Blake- Herbert,** Group Director Communities and Resources
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Policy context:	***Pension Investment Strategy***
Financial summary:	The aim of the CIV is to seek reductions in the cost of investment management fees that would arise from the economies of scale. The level of savings achieved by Havering would be dependent upon the amounts invested via the CIV and the discounts in fees achieved. Each member of Authority would be required to make an investment to meet the start-up costs of £75k upon joining plus regulatory capital contributions ranging from £150k to £300k over the next three years.
Is this a Key Decision?	Yes
When should this matter be reviewed?	As required
Reviewing OSC:	Overview and Scrutiny board

The subject matter of this report deals with the following Council Objectives

Havering will be clean and its environment will be cared for	[]
People will be safe, in their homes and in the community	[]
Residents will be proud to live in Havering	[x]

SUMMARY

In 2013 the coalition Government in considering the future of Local government pension schemes expressed concern over the level of Investment fees paid by Councils and suggested that by pooling schemes together funds could achieve significant savings in fees.

In an attempt to reduce pension fund investment management costs, the creation of a London LGPS Collective Investment Vehicle (CIV) has now been made through London Councils. The vehicle would allow pension fund investments to be pooled for the purpose of reducing fund managers' fees.

This report asks the Cabinet to consider whether the Council wishes to participate in joining the Collective Investment Vehicle (CIV) in London. This is vehicle will enable Pension Funds in London, including the London Borough of Havering Pension Fund to access fund managers through this platform, should the Pensions Committee decide it is appropriate to invest and participate in the cost savings and other benefits associated with this vehicle.

RECOMMENDATIONS

Cabinet is asked to consider whether:

1. It wishes to participate in the establishment of the London (LGPS) Collective Investment Vehicle (CIV).

2. It wishes to participate in the establishment of a private company limited by shares to be incorporated to be the Authorised Contractual Scheme Operator (the 'ACS Operator') of the London (LGPS) Collective Investment Vehicle (CIV), the ACS Operator to be structured and governed as outlined in this report.

3. Subject to approval of (1) and (2) above Cabinet agrees:

   a) That following the incorporation of ACS Operator, the London Borough of Havering:

      - Become a shareholder in the ACS Operator.
      - contribute to the initial capital set up costs of the ACS Operator :
      - appoint an executive member to exercise the Council's rights as shareholder of the ACS Operator;

   b) That Under Regulation 11 of the Local Authorities (Arrangement for the Discharge of Functions) (England) Regulations 2012 to establish the

Pensions CIV Joint Committee, pursuant to the existing London Councils Governing Agreement dated 13 December 2001 as amended, to act as a representative body for the Local Authorities participating in these arrangements; and

c) To delegate to this 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.

REPORT DETAIL

1. BACKGROUND

1.1 1n 2013 the coalition Government (the Pensions Minister, Brandon Lewis) called for a consultation on the future of Local Government Pension Funds (LGPF), arguing that the current level of fees paid by Councils investing funds is too high. He also made his views clear at the National Association of Pension Funds Conference in May 2013 by saying, 'If it takes a smaller number of funds to improve the efficiency and cost effectiveness of the scheme, I shall not shy away from pursuing that goal'. It has been suggested that a pooled scheme would reduce the investment management fees and would result in greater collective buying power for councils.

1.2 A joint London Borough Pension Working Group initiative is looking at ways in which pension schemes can work together to get financial benefits and efficiencies of scale from joint working.

1.3 A pensions working group led by London Councils proposed to launch a collective investment vehicle to enable London Boroughs to participate in a scheme of joint pension fund investing. It will be an Authorised Contractual Scheme (ACS). This scheme will have FCA (Financial Conduct Authority) approval. It was originally planned to launch the scheme in February 2015, although it is more likely to happen later in the year.

1.4 This work is partly in response to the Government's review of Local Government Pension Schemes. Further Government announcements may be made to request more joint working by councils to reduce administration costs.

1.5 If Havering Council invests in the scheme, then it will have the option of joining the ACS Collective Investment Vehicle if the investments available are in line with the pension investment strategy and will offer reduced costs to the fund.

1.6 In theory, the Council could move an unlimited amount of its investments into the scheme if they were in line with the investment strategy and offered reduced fees. The Council pension scheme has around £570 million of investments with annual direct management fees total around £1 million. Investments within the fund are likely to be unitised fund type investments.

1.7 To maximise the value of pension schemes, ways to reduce the volume of management fees charged to pension schemes are being explored. This Collective Investment Vehicle approach has been designed by London Councils as a way in which similar investment types within different London Boroughs can be combined to benefit from smaller fee charges. Fund manager's fees are based on the size of the fund and are based on a percentage of the amount managed. The larger the fund, the lower the percentage fee charged.

1.8 The use of the CIV is a matter for the Pensions Committee to consider at a later date when the mechanism is available. At this stage the executive decisions required are in relation to establishing the corporate framework to facilitate the arrangements. The Council's participation in developing the CIV is sought by investing a nominal £1 to become a shareholder in the venture and establishing a management structure. Further contributions are required to facilitate the setting up of the CIV and are considered as part of the financial implications to this report. The decisions required are in relation to executive functions.

2. CURRENT LONDON BOROUGH PENSIONS SCHEMES

2.1 At present each London Borough has its own pension scheme. Each scheme is managed by its own Pension Committee and has a range of investments intended to provide a sufficient return to meet pension liabilities. All schemes will have similar, but not identical range of investments.

2.2 All schemes are likely to have investments in equities (UK and overseas), property and bonds. Some schemes may have more alternative investments such as private equity, infrastructure or hedge funds.

2.3 The Havering pension scheme invests in a range of assets including equities, Property, Bonds and Gilts which are managed by six specialist fund managers. A passive tracker manager,(SSGA) tracks share indices, The Active managers, such as Baillie Gifford are used with the intention of outperforming stock market index movements. Active managers charge higher fees than passive managers.

2.4 Manager fee structures – fees are based on a percentage of the amount of the funds invested. As the amount invested increased, managers usually charge a lower fee percentage. This should also apply to custodian costs of holding the investments securely.

2.5 As a number of councils use the same pension fund managers, then the combination of investments will mean the lower fee thresholds will be exceeded, thus reducing the fees payable. It is the saving of these fees and in theory, the appointment of high performing managers that should provide a financial advantage for the council's pension fund from using the ACS. The Council paid direct fund management fees of around £1 million in 2014/15

2.6 The scheme has a minimum target investment size of £5bn across all investors; though it is hoped investments will be significantly higher. 30 of the 33 London Boroughs have expressed an initial interest in the scheme and have made contributions to meet the set up costs.

2.7 A new Pensions CIV Joint Committee will be established under the London Councils arrangements and will oversee the ACS operator. Participating councils will appoint members and officers to the Joint Committee.

2.8 The creators of the ACS have been liaising with a number of investment managers to see the likelihood of their participation. At this stage a number of managers have expressed an interest including some who do not have many local authority clients. If managers believe there is more chance of obtaining or keeping business by being in the ACS (even at a lower fee level), then the scheme should be successful.

2.9 Though there will be further costs of setting up and managing the scheme, the management fee savings are expected to be around double those of running the scheme.

3. INVESTMENT IN THE ACS COLLECTIVE INVESTMENT VEHICLE

3.1 To take part in the ACS Collective Investment Vehicle, each London Borough will be asked to buy a nominal £1 share in the fund. Those Boroughs that participate in the scheme will then be asked to contribute an equal share of £100,000 of initial capital (i.e. if there are 33 initial investors including LBH, the contribution would be £3,225). Over the first three years of the scheme it is anticipated that each Authority will need to contribute in the region of £150,000 and £300,000 toward the regulatory capital needs of the ACS.

3.2 At present, we don’t know which fund managers will be participating in the scheme. If the investment options available in the ACS don’t suit the needs of the LBH pension fund, then the council is under no obligation to participate further. Most of the fund managers the council employs have been performing above average over the last year. However, the benefits of membership in the CIV will only be achieved through investing in the fund and benefiting from a reduction in management fees.

3.3 Once the ACS is operational, it is likely that the first group of investments available will include tracking funds that simply perform in line with share indices, such as the FTSE. These funds are bought and sold in units and have the lowest management fees. If the council wishes to hold non-standard investments, then these will probably remain outside the ACS. It should be noted that the standard nature of ACS investments could limit the council from involvement in investment Decisions as the managers will manage funds from the perspective of all investors.

3.4 If the council’s existing managers opt to take part in the ACS, then there may be potential to move the council’s investments into the ACS to obtain lower fees with minimal administrative work.

3.5 The scheme will have an appointed custodian to hold the investments. Though the council's investments will be combined with other council's investments to achieve volume savings, LBH's share of investments will need to be clearly identifiable. The council will need to be able to see its investments when needed to pay pensions due.

3.6 Before placing pension fund investments in the ACS, legal approval for this investment will be needed. The scheme organisers have been taking legal advice throughout the development stages

REASONS AND OPTIONS

Reasons for the decision:

The decision is required to enable the Pension Fund to participate in the development of the CIV in order to increase collaboration amongst London Pension Funds and to benefit from potential savings in management fees over the longer term.

Other options considered:

Although there is no compulsion to join the CIV, Cabinet should to be mindful of potential changes in legislation which may impact upon the structure of the Fund.

The LGPS Scheme Advisory Board (The Board) was established under the Public Service Pensions Act 2013 to advise the Secretary of State for Communities and Local Government on the development of the Local Government Pension Scheme.

In support of its work plan for 2015-16, the Board is inviting proposals from interested parties to assist it in developing options with regard to the increased separation of LGPS pension funds and their host authorities for consideration prior to potentially making recommendations to the Secretary of State.

It is expected that the Board will make recommendations to the Secretary of State during September. The Board is likely to consider the following three options:

- A greater separation of powers of the Pension Fund under a strengthened s151 role.
- Joint Committees of two or more Pension Funds
- Complete separation of the Pension Fund from the host authority

It is too early to suggest whether any of these or alternative options are developed further. The creation of the CIV may be viewed as a means of mitigating any further legislative measures to merge funds.

IMPLICATIONS AND RISKS

Financial Implications and risks:

The London Borough of Havering is the Administering Authority of the London Borough of Havering Pension Fund and has the delegated responsibility for decisions regarding the Pension Fund to the Pensions Committee.

There is pressure on LGPS funds to demonstrate efficiency savings and work collaboratively. This decision would enable LBH to participate in developing a cost-saving mechanism for pension fund investment across London. By establishing the mechanism the Pensions Committee will be able to decide whether there are advantages in investing via this collaborative venture.

The theory of the CIV is that fund managers will charge a lower management fee on pooled investments managed. By participating in the CIV the Havering Pension Fund would have access to a developing range of investment products at a lower cost than would be available than if operated independently of the CIV.

The employer's contribution is a significant element of the Council's budget and consequently an improvement in investment performance or reduction in management fees may reduce the contribution rate and increase the funds available for other corporate priorities.

As a member of the CIV the Pension Fund will contribute to the cost of meeting the set up costs of the CIV which will require an amount of £75k payable immediately upon joining.

In addition to the set up costs there will be a requirement to meet the Regulatory Capital contribution required from all boroughs, this is a statutory requirement for the CIV and the minimum contribution has to be paid before the ACS can be FCA authorised. The ACS will need a minimum of £100k before the company can be authorised, therefore £3,500 from each participating borough will be required (based on 30 boroughs currently participating).

The Regulatory Capital contribution for the CIV is calculated based on the estimated value invested in the CIV. Currently it is estimated that the amounts to be paid over the next three years will be in the region of £150k to £300k, as the maximum regulatory capital for the CIV is £10m.

The costs will be met from pension fund surplus cash if available or alternatively be met from the sale of pension's assets.

It is anticipated that the saving achieved form the CIV will outweigh the costs associated with its operation. However, the pension fund remains free to choose where it invests and savings can only be achieved if suitable products are available within the fund. It should also be remembered that investment performance is the key driver for the long term growth of the fund.

Legal Implications and risks:

Regulation 11(3) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 requires the Council, as an administering authority, to invest fund money that is not needed immediately to make payments from the Pensions Fund.

Regulation 11(1) requires the Council to have a policy in relation to its investments. The investment policy must be formulated with a view –

(a) to the advisability of investing money in a wide variety of investments; and
(b) to the suitability of particular investments and types of investments.

The Council is also required to have a Statement of Investment Principles in accordance with regulation 12 (1) which covers the following matters:

(a) the types of investment to be held;
(b) the balance between different types of investments;
(c) risk, including the ways in which risks are to be measured and managed;
(d) the expected return on investments;
(e) the realisation of investments;
(f) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments;
(g) the exercise of the rights (including voting rights) attaching to investments, if the authority has any such policy; and
(h) stock lending.

In accordance with Regulation 11(5), The Council is required to take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.

It is desirable for the Council to take steps to reduce the costs of administering its pension fund. The proposal to create a Collective Investment Vehicle appears to be viable way to achieve savings.

Under the Local Government (Functions and Responsibilities) (England) Regulations 2000 (as amended), functions relating to local government pensions etc. are designated as non-executive functions. Thus, any decision to invest through the CIV would be a matter for the Pensions Committee, being a non-executive Committee of the Council charged with discharging the Council's obligations and duties under the Superannuation Act 1972 and the various statutory requirements in respect of investment matters.

The decisions sought in this report are not in regard to pensions functions, but concern participating in the establishment of a private company and becoming a shareholder of it. Those decisions are executive functions and it is appropriate for Cabinet to make them.

Under Regulation 11 of the Local Authorities (Arrangement for the Discharge of Functions) (England) Regulations 2012, the authority has power to make arrangements for the discharge of its functions by a Joint Committee and for the delegation of such functions to the Joint Committee. As the Joint Committee proposed will exercise executive functions it is appropriate for the Council's executive to approve the establishment of the Joint Committee and the delegation of executive functions to it.

Where a Joint Committee is exercising executive powers, the Regulations require that Members appointed to it are executive Members. However where the Joint Committee comprises five or more authorities, as this Joint Committee will be, either executive or nonexecutive Members may be appointed. Notwithstanding where the functions to be are exercised are entirely executive it would be most appropriate to appoint executive members

Human Resources Implications and risks:

There are no direct Human Resource implications associated with the proposals

A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

Equalities implications and risks:

None arising directly from the consultation.

BACKGROUND PAPERS

None