

Committee: Cabinet

Date: 23 April 2014

Agenda item:

Wards: All

Subject: Collaboration by London Councils for a Collective Investment Vehicle

Lead officer: Caroline Holland

Lead member: Councillor Mark Allison

Forward Plan reference number: ??

Contact office: Paul Dale

Recommendations:

That Cabinet:

- a)** agree to 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;
- b)** note that participation by London Boroughs is voluntary;
- c)** agree to contribute £1 to the ACS Operator as initial capital;
- d)** 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;
- e)** to nominate the Chair of the Pension Fund Advisory Committee authority to act as the Leader's deputy for the Council in exercising its rights as a shareholder of the ACS Operator.
- f)** To note that should members agree to recommendations a) and c), there is a possibility that there could be a call from shareholding boroughs for a small initial investment as discussed in section 2.12 for capital required for the initial authorisation of the Operator The Director of Corporate Services will clarify this issue prior to signing any membership agreement and report further to the Cabinet meeting. The Director of Corporate Services would make any minor spending/investment decision required under delegated authority following consultation with the Cabinet Member for Finance and the chair of the Pension Fund Advisory Panel and would report any action to subsequent meetings of both Cabinet and Panel.
- g)** Note that other investments will be considered by PFAC and a recommendation made to the appropriate decision making body.

1. SUMMARY

- 1.1 The Pension Fund Advisory Committee (PFAC) at its meeting of 19 March 2014 considered the proposal from London Council's Leaders Committee that London Boroughs collaboratively set a London-wide collective investment vehicle (CIV).
- 1.2 The future of management of the Local Government pension scheme has been the subject of much political and academic debate in recent years. The Local Government Pension Scheme (LGPS) is distinct from the other main public sector schemes in being funded. This means that contributions from employers and employees are placed in a fund that is then invested in assets such as stocks and shares, property and government bonds. These accumulated assets will be used to pay out pensions when they become due in the future. Getting a good return on the investments is crucial to the health of the pension fund and as any deficit for council employees in the scheme is picked up by the revenue budget it is also important to the council's general financial position,
- 1.3 Currently there are over 80 schemes in England and Wales, with 33 of these being administered by each London Borough and the City Corporation. Merton manages one of the smaller of the schemes with assets of c. £500m
- 1.4 There are those who have argued that there are economies of scale that can be gained by merging schemes into a smaller number of funds and potentially into one National Fund. The Government currently has a review underway on the future of the LGPS.
- 1.5 Conversely others have argued that the case for merger has not been made and that this could have several drawbacks
 - The evidence that performance is directly linked to increase in size has not been fully made to the satisfaction of all
 - Some have argued that asset selection and benchmarking have had the main impact on performance rather than a narrow focus on fee minimization.
 - There could be a loss of local accountability with some of the schemes
 - The scale of investment pots required could limit the number of investment managers able to provide the service hence reducing competition amongst providers
- 1.6 London Councils' Leaders committee has for some time been exploring an option, a Collective Investment Vehicle (CIV) that attempts to gain potential economies of scale without some of the perceived disbenefits. In this model existing pension funds would remain in place but they would voluntarily pool money to be invested collectively. The higher sums invested should produce lower investment fees but decisions on the patterns of investment would remain locally with boroughs.
- 1.7 This report requests members to take the next steps in enabling this CIV approach to be developed and for the Pension Fund to set the foundation to enable it use the vehicle should it require it in the future. PFAC took the view that the CIV was an option that they would like

to have available to them as they are currently reviewing the investment mandate of the fund. At this stage, however, they are not seeking to commit to any particular level (or indeed any) investment.

2 DETAIL

London Councils Leaders' Committee has considered the issue of collective investments for London Pension Funds throughout 2012 and 2013. They have concluded that more collaboration between boroughs that wished to collectively invest some or all of their pension funds would be likely to produce significant savings. The London Councils Leaders' Committee has approved the detailed business case and a proposed governance structure. They have also approved that a London Local Government Pension Scheme (LGPS) Collective Investment Vehicle (CIV), in the form of a UK based, Financial Conduct Authority (FCA) approved, authorised Contractual Scheme (ACS) be set up. This report details the action that the Council needs to take to enable participation.

2.2 At their meeting on 11 February 2014, London Councils Leaders' Committee approved that they should recommend to the London boroughs that they proceed to establish an Authorised Contractual Scheme (ACS) and an ACS Operator (which is the company that would manage the ACS). This would require London boroughs to agree to become shareholders in the ACS Operator and delegate oversight of the company to a Joint Committee hosted by London Councils. A copy of the paper submitted to London Councils Leaders Committee is appended (Appendix A). The Report sets out the likely Governance structures and key principles. The principles include:

- investment in the ACS should be voluntary;
- ability to choose how much to invest in individual asset classes;
- boroughs should have sufficient control over the ACS Operator;
- the ACS Operator would provide regular information to participating boroughs; and
- Authorities seeking to invest in the ACS will also take a shareholding interest in the Operator (and have membership of the Pensions CIV Joint Committee).

2.3 The Joint Committee would be established under the existing London Councils arrangements to assist in the appointment of directors to the ACS Operator. The Pensions CIV Joint Committee will comprise elected Councilors nominated by participating boroughs as provided for under the existing London Councils Governing Agreement.

2.4 Information will be provided regularly by the ACS and the ACS Operator to local authorities investing, and their Pension Committees and officers, and the Pensions CIV Joint Committee. Directors of Finance will provide advice to both the borough Pension Committees (as they do now) and to their authority's representative on the Pensions CIV Joint Committee. The London Council's report proposes that the Chairman of the Pensions Committee represents the Council or in the event that all 33 boroughs decide to join then the Leader fulfills this role, as in that event the existing London Councils Leaders Committee can undertake the role.

2.5 The business case considered by London Councils analysed the savings, benefits and costs for a variety of different levels of collective assets under management: £24bn, £10bn and £5bn, producing estimated annual net savings of £112.2million, £44.9 million and £20.9million respectively. It is considered that a reasonable minimum target size of assets

under management for the ACS is in the range of £5bn. This is based on analysis of existing investments held by London borough funds and also takes into account that initially the majority of investment mandates are likely to be passive mandates. Over time, it is expected that actively managed mandates and investments into alternatives such as property and infrastructure assets may be added to the range of investments offered by the ACS.

- 2.6 All London boroughs have been asked to respond in writing to the London Councils Chief Executive on their decision on two issues: whether to join the CIV Company and also to participate in a new Joint Committee that is being set up to govern the structure.
- 2.7 At this stage no commitments to any future investments are being sought. The proposal at this stage is purely to establish a mechanism that would allow collective investments to be made. Decisions to make any investment would only be made by members following consideration by PFAC on the recommendation of its Investment adviser and consideration that such investments is in line with the strategic asset allocation of the pension fund. PFAC would also be considering whether there are transition fee implications to move investments from existing investment managers to the CIV. Other issues like the fees to be charged by the operator would be considered.
- 2.8 It should be noted that, participation is voluntary by boroughs, and even if a borough decides to participate each borough will make separate decisions to invest, disinvest or not invest at all for each asset mandate in the same way that Pensions Committees do currently. It is expected that the decision as to whether to invest in the ACS would be made by individual boroughs later in the year. There is nothing in the decision or report that locks any borough into any level of commitment to invest or at what stage in the process not to proceed.
- 2.9. To date the initial one off costs of working up the CIV have been met by an initial contribution of £25,000 each from 25 of London's 33 boroughs.
- 2.10 In broad terms, the proposed structure is that the boroughs will own all the share capital of the ACS Operator. Initially this will require minimal share capital (£1 per borough) but this capital requirement will increase once the operator is authorised and investments are made in the ACS. It is anticipated that, some or all of, the capital contributions will be converted into bond investments that form part of the investments of investing boroughs.
- 2.11 Following the report to the London Councils Leaders Committee further information has been provided by London Councils (attached as Appendix 2) This identifies that at there are 2 points at which the Operator of the Authorised Contractual Scheme will require further capital: the initial authorisation of the Operator and then the date on which the Operator goes live in terms of managing the ACS fund.
- 2.12 The Operator is likely to be authorised in mid to late 2014 and accordingly at this point, regulatory capital of €125,000 will be required. At this stage it is not clear if the shareholders would be required to contribute this or if it will be restricted to those making actual investments. London Councils have now indicated that shareholding boroughs could be asked to share the initial €125k. The London Councils' estimate is that there are likely to be at least 20 boroughs leading to an investment of c. €6,250 apiece. It should be noted that this is not an expense but would be an investment that would be made in bonds or cash. The participating boroughs would

retain the value of the investment but there may be a small loss of income from them.

2.13 London Councils' have expressed the view further capital requirements will be required, as investments start to flow, and would be linked to the scale of investment being made. The paper (Appendix 2) notes that there is a capital ceiling of €10m, which, on the basis of 20 boroughs, would equate to a total capital requirement of €500k per borough. Both of the capital calls are based on the requirements of the regulatory regime.

2.14 As the paper notes, all of this capital would be invested in liquid assets and would be returned to a borough if they decided to withdraw from the CIV, although again the precise details of how this would operate are still to be worked through.

2.11 In the longer term, running costs incurred in operating the CIV would be recoverable from participating boroughs who actually invested in the funds operated by the CIV. The intention is that these would be more than paid for from reduced fees. The objective of the CIV is to harness the joint purchasing power of the participating boroughs to drive down fund managers' fees and improve investment performance. The CIV could potentially provide an expedient way of enhancing investment objectives of the London Borough of Merton Pension Fund without undermining Member control and autonomy.

3. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

Financial Implications have been included in this report. The council has contributed £25k under delegated authority from the Pension fund towards the exploratory work on setting up the CIV.

4. LEGAL AND STATUTORY IMPLICATIONS

4.1 London Councils commissioned external legal advisers, Eversheds LLP, to advise on the statutory powers to enter into this arrangement and to advise on matters regarding governance. The advice is available as a background paper.

4.2 Eversheds advised that the matters requiring decision in this report are matters for the executive. Therefore, the decision to establish a joint committee is also an executive decision.

4.3 Under the provisions of the London Councils Governing Agreement the Leader is the Council's representative on the joint committee but the Leader is able to appoint a deputy. Under Regulation 12(3)(a) of the Local Authorities (Arrangements for the Discharge of Functions) (England) Regulations 2012, non-executive members can be appointed to an executive joint committee if there are more than 5 participating authorities.

5. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION KLE

IMPLICATIONS

This report has no direct human rights, equalities and community cohesion implications

6. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

N/A

7. APPENDICES

1. London Council's Leaders Reports presented at London Council meetings between March 2012 to December 2013

2 Further London Council's Guidance on Timing and quantum of regulatory capital requirements for London Councils' Operator of the Authorised Contractual Scheme

8. BACKGROUND PAPERS

High level detail on the governance arrangements and FCA regulation of the ACS Operator and the Pensions CIV Joint Committee – Eversheds 13 February 2014