

COMMITTEE: Pensions Committee	DATE: 25 February 2014	CLASSIFICATION: Unrestricted Report Restricted Appendix	REPORT NO.
REPORT OF: Interim Corporate Director of Resources ORIGINATING OFFICER(S): Kevin Miles – Chief Accountant		TITLE: Investment in London LGPS Common Investment Vehicle Ward(s) affected: N/A	

Community Plan Theme	All
Strategic Priority	One Tower Hamlets

APPENDIX - NOT FOR PUBLICATION

The Sub-Committee may by resolution exclude the public from the meeting during an item of business where it is likely, in view of the nature of the business, that there would be disclosure of exempt information as defined in Section 100I and Schedule 12A of the Local Government Act 1972. To be exempt, information must fall within one of the categories listed in paragraphs 1 to 7 of Schedule 12A, must not fall within one of the excluded categories in paragraphs 8 and 9 and the public interest in maintaining the exemption must outweigh the public interest in disclosing the information.

This report contains information falling within paragraphs 4 and 5 of Schedule 12A - "Information relating to any consultations or negotiations or contemplated consultations or negotiations, in connection with any labour relations matters arising between the authority, or a Minister of the Crown and employees of, or office holders, under the authority"; and "Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings." There is a public interest favouring public access to local authority meetings reflected in the provisions of Part VA of the 1972 Act. Public access promotes accountability, transparency and public involvement. In this case however, the report contains information relating to consultations or negotiations in respect of the recruitment of the post of Chief Executive. The Committee may take the view that the public interest in maintaining the exemption on the information outweighs the public interest in disclosing it.

Note - Further legal advice was taken on the nature of the documents to be discussed as a result of which the contents and appendix of the report were considered to be suitable for discussion in open session. Accordingly the documents have been made available as a supplement

1. SUMMARY

- 1.1 In an attempt to reduce pension fund administration costs, the creation of a London wide common investment vehicle is being created through London Councils. The fund would allow pension fund investments to be pooled for the purpose of reducing fund manager's fees as a lower fee is charged the larger the investment.
- 1.2 At the moment, the scheme is in its early stages of development. This report is to ask the Pensions Committee for approval to participate in the scheme – an initial capital investment of £1 is required at this stage to register interest. However this

does not commit the Council to any future investment but would enable the Council to be involved in the development of the concept.

- 1.3 Before any major policy change takes place in relation to investment through this medium, Full Council authority will be sought for approval of the principle and any decisions to transfer pension fund investments to the Common Investment Vehicle would need to be approved by this committee. The investments available in the Investment Vehicle would need to match the council's investment strategy.

2. DECISIONS REQUIRED

- 2.1 The Committee is recommended to agree that the Pension Committee of the London Borough of Tower Hamlets pension scheme become a shareholder in the ACS Operator
- 2.2 Agree that the fund invests £1 to the ACS Operator as initial capital.

3. REASONS FOR DECISIONS

- 3.1 The proposal provides the potential to take advantage of lower investment management fees thereby achieving a saving to the pension fund. By becoming a shareholder from the inception the Council would be able to participate in the development of the project but without any long term commitment to invest which would necessitate further decisions once the methodology has been agreed.

4. ALTERNATIVE OPTIONS

- 4.1 The theory of the CIV is that fund managers will charge a lower management fee on pooled investments managed. If the CIV investment proves to be a popular fund, then if the Tower Hamlets fund was outside the scheme it would not have the potential to benefit from economies of scale.

5. BACKGROUND

- 5.1 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.
- 5.2 A pensions working group led by London Councils is proposing to launch a common 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 is currently planned that the scheme will be launched in February 2015, though this date may slip to later in 2015. Details of the proposed scheme are shown in the attached London Councils report.
- 5.3 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.

- 5.4 If Tower Hamlets Council invests £1 capital in the scheme, then it will have the option of joining the ACS Common Investment Vehicle if the investments available are in line with the pension investment strategy and will offer reduced costs to the fund.
- 5.5 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 £1 billion of investments with annual management fees total around £2.3 million. Investments within the fund are likely to be unitised fund type investments.
- 5.6 **Pension Committee will need to approve membership of the ACS and will be asked to approve an initial investment of £1 at this stage to register an interest in participating. There is no further obligation to participate or invest at this stage.**
- 5.7 To maximise the value of pension schemes, ways to reduce the volume of management fees charged to pension schemes are being explored. This Common 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.

6 CURRENT LONDON BOROUGH PENSIONS SCHEMES

- 6.1 At present each London Borough has its own pension scheme. Each scheme will be managed by its own Pension Committee and will have 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.
- 6.2 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.
- 6.3 The Tower Hamlets pension scheme invests in equities, property, bonds, Gilts and growth funds (these can invest in a range of investments with the aim of achieving a higher return). Passive, tracker managers who track share indices, such as Legal & General are used. Active managers, such as Baillie Gifford and GMO are used with the intention of outperforming stock market index movements. Active managers charge higher fees than passive managers.
- 6.4 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.
- 6.5 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 fund management fees of around £2.3 million in 2012/13

7. ACS PROPOSALS

- 7.1 The scheme has a minimum target investment size of £5bn across all investors; though it is hoped investments will be significantly higher. 31 of the 33 London Boroughs have expressed an initial interest in the scheme.
- 7.2 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. The proposed structure is shown in paragraph 11 of the appendix.
- 7.3 The creators of the ACS have been liaising with a number of investment managers to see if they will be likely to participate. 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.
- 7.4 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. Please refer to paragraph 43 of the progress report attached to see details of the costs and potential savings.

8. INVESTMENT IN THE ACS COMMON INVESTMENT VEHICLE

- 8.1 To take part in the ACS Common Investment Vehicle, each London Borough will be asked to buy a £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 10 initial investors including LBTH, the contribution will be £10,000).
- 8.2 Once investments are placed in the fund, the OCS Operator will require further capital of 2 to 3 basis points (0.02%-0.03%) of the sums invested. For example if the council invested £100million in the scheme, the additional capital investment would be £40,000. This £40,000 would be funded from the transfer of existing pension fund Gilt investments into the fund. This investment requirement by scheme operators is common to investment schemes of this type.
- 8.3 LBTH has already contributed £20,000 to initial set up costs of the scheme to get the proposals to this stage of development.
- 8.4 At present, we don't know what fund managers will be participating in the scheme. Until more details are available, no further investment other than the initial £1 investment will be required. If the investment options available in the ACS don't suit the needs of the LBTH 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.
- 8.5 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.

- 8.6 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.
- 8.7 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, LBTH'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.
- 8.8 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

9. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 9.1. The comments of the Corporate Director Resources have been incorporated into the report.

10. LEGAL COMMENTS

- 10.1 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 cover 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.

- 10.2 It is desirable for the Council to take steps to reduce the costs of administering its pension fund. The proposal to create a Common Investment Vehicle appears to be a viable way to achieve savings.
- 10.3 Pursuant to the above duties and powers the Council has capacity to explore and develop a methodology for a more efficient and effective means of investing pension fund assets. These proposals do not commit the Council to more than the nominal sum of £1 to join the consortium of London Boroughs and if, at the end of the development phase, it appears to be worthwhile for the Council to invest through this mechanism, a further report will be required.
- 10.4 Lawyers for the Boroughs are collaborating to ensure that advice given to their authorities is consistent and appropriate. Legal Services will engage with colleagues from the other participating Boroughs to ensure that the best possible advice is given to this Committee and the Council.
- 10.5 There are no immediate legal implications arising from this report though legal considerations will arise in the course of the development of the arrangements which will be addressed appropriately as and when required.

11. ONE TOWER HAMLETS CONSIDERATIONS

- 11.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance or reduction in management fees will reduce the contribution and increase the funds available for other corporate priorities.
- 11.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

12. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 12.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

13. RISK MANAGEMENT IMPLICATIONS

- 13.1 Any form of investment inevitably involves a degree of risk.
- 13.2 To minimise risk the Investment Panel attempts to achieve a diversified portfolio. Diversification relates to asset classes and management styles.

14. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 14.1 There are no crime and disorder reduction implications arising from this report.

15. EFFICIENCY STATEMENT

15.1 The monitoring arrangement for the Pension Fund and the work of the Pension Fund Investment Panel should ensure that the Fund optimises the use of its resources in achieving the best returns for the Council and members of the Fund.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"

*Name and telephone number of holder
And address where open to inspection*

CIV investment presentation slides