Non-Executive Report of the: **PENSIONS COMMITTEE** **9 March 2016**	TOWER HAMLETS
Report of: Zena Cooke, Corporate Director of Resources	**Classification:** Unrestricted
Collaboration Work Update –National LGPS Procurement Framework and London Collective Investment Vehicle (CIV)	

Originating Officer(s)	Bola Tobun, Investment and Treasury Manager
Wards affected	All

Summary

This report provides the Committee with an update on the progress of the Collective Investment Vehicle (CIV) being set up by local government funds in London in collaboration with London Councils.

It also provides an update on the progress of the National LGPS Procurement Frameworks, in which the Fund is involved.

Recommendations:

Members of the Pensions Committee are asked to:

- Formally agree the fund participation in the re-letting of National LGPS Framework for Actuarial, Benefits & Governance Consultancy Services and the Investment Consultancy Services.
- Note the progress made to date in the re-letting of National LGPS Framework for Actuarial & Benefits Consultancy Services and the Investment Consultancy Services.
- Note the progress on implementation and fund launch of London CIV.

1. REASONS FOR THE DECISIONS

1.1 Members are being asked to formally agree the Fund participation in the re-letting of the National LGPS Procurement Framework as it is expected that having this framework in place will afford an improve buying power, procurement efficiency and significant amount of cost savings.

1.2 This will allow all LGPS Funds in the UK quicker and more efficient access to high-quality pension fund services by removing the need to independently undertake a full European Union (OJEU) equivalent procurement. The greater interest the framework can demonstrate when it goes to the market, the better the delivery outcome would be.

1.3 Any costs associated with delivering this frame work are immaterial in the context of the benefits that will accrue to the Fund. The actuarial framework will have two income streams. The first of which is a joiners' fee, any fund that wishes to use the framework will pay a one off fee. The joiners' fee will be agreed with all founders prior to the launch of the framework. This income stream lasts until the framework closes for business. The second income stream is a Management Rebate, which is paid by suppliers. This is a percentage (currently 1% on all other frameworks) that is paid to the National Frameworks on all invoiced spend. This income stream continues until the last contract let through the framework comes to an end.

1.4 The cost of managing the frameworks are covered by these income streams. Surplus income is then used to repay the founder authorities set up costs. If there is any further surplus the founder authorities will agree how best to use this money.

2. ALTERNATIVE OPTIONS

2.1 To independently undertake a full European Union (OJEU) equivalent procurement for services, this can be long, painstaking and expensive.

3. DETAILS OF REPORT

National LGPS Procurement Framework

3.1 The National LGPS Frameworks procurement initiative was named 'Best Collaboration' at the prestigious LGC Investment Awards, November 2015. The award comes amid increasing pressure on Local Government Pension Scheme (LGPS) Funds to join forces in order to cut costs and pay down deficits.

3.2 This project has delivered demonstrable savings, and will deliver future savings" said the LGC judges "It is so far ahead of others." The frameworks are already proving their worth in terms of procurement efficiency and buying power, with measured savings of over £16 million so far. "So many Funds are benefitting from this collaboration" said Nicola Mark, Chair of the National LGPS Framework group "With over half of LGPS Funds engaging with the frameworks, they are rapidly becoming ‘the norm’ for procurement across the LGPS.”

3.3 A ground-breaking collaboration between several LGPS Funds, the frameworks enable the LGPS to leverage its combined buying power while crucially still supporting local decision making and service requirements. The frameworks allow all LGPS Funds in the UK quicker and more efficient access to high-quality pension fund services by removing the need to independently undertake a full European Union (OJEU) equivalent procurement. All participating Funds benefit from pre-agreed Terms and Conditions and ceiling prices established under the frameworks, along with a collaborative rebate.

3.4 The Department of Communities and Local Government (DCLG) have recognised “there are clear advantages and savings to making use of the National LGPS Frameworks. Funds should give serious consideration to making greater use of these frameworks.” The project continues to develop to support the Government’s agenda for cost saving reform of LGPS investments.

3.5 The National LGPS Frameworks operate on a ‘not for profit’, self-funding model - ‘by LGPS Funds, for LGPS Funds’. No Fund takes a profit from other Funds and all LGPS Funds and employing authorities using the frameworks benefit equally from the collaboration – all benefits are retained in the LGPS.

3.6 The procurement services currently available under the National LGPS Frameworks are; Global custodian, Actuarial, Governance and Benefit Consultancy Services, Investment Consultancy Services and Legal Services. The recently launched Legal Services framework is not only open for all LGPS Funds and employing authorities nationally, but for wider public sector pension bodies too. Funds can use the framework to procure legal services matched to their own specific requirements; from small, one-off pieces of work to longer-term, single supplier arrangements.

3.7 Accessing legal advice can be difficult for LGPS Funds, particularly those that don’t regularly need these services and may be unfamiliar with the marketplace. The National LGPS Framework for Legal Services offers an easy procurement route to a range of specialist, qualified legal services providers, chosen for their specific pensions and investment expertise.

3.8 One of the officers of the Fund currently working closely with a number of other LGPS fund officers to develop re-letting of some services under the national procurement framework.

3.9 Current frameworks under development include the re-letting of the actuarial, benefits & governance consultancy and investment consultancy frameworks as they are nearing the end of the 4 year framework lifespan. In addition the Environmental, Social and Governance (ESG) Framework is currently being developed and it is anticipated that this framework will be available for call off by early summer 2016. This is likely to offer a number of lots, which funds will be able to call off including voting services, governance overlay and research work.

3.10 It is anticipated that work will also commence shortly on the formation of a framework for third party administration services. Consideration is also being given by the National Frameworks for the establishment of a passive fund manager framework and a transition manager framework.

3.11 The Fund has been a keen proponent of collaborative working believing that this will deliver benefits to the Fund not just in terms of financial savings but also delivering wider governance benefits.

London CIV

3.12 London CIV is currently undergoing Implementation and fund launch process, termed Phase 1 – which is being delivered through what has become known as the "commonality" strategy. This broadly involves seeking to aggregate borough investments where two or more boroughs are invested with the same investment manager in the same or a very similar mandate, the aim being to increase efficiency and drive down cost.

3.13 The commonality strategy is a pragmatic approach that quickly delivers scale benefits for the boroughs and fee income for London CIV to cover operating costs. Phase 1 is the prime focus of activity in terms of fund opening through the first half of 2016.

3.14 Implementation of the strategy began with the analysis of investment data gathered from across the boroughs in 2014, the aim of which was to discover which Investment Managers (IMs) the boroughs were invested through, in what asset classes and the underlying mandate strategies. This analysis showed that the 33 funds had holdings with close to 90 IMs through around 250 separate mandates. It also showed that while there was significant commonality in some asset classes (e.g. passive equity) other classes (e.g. fixed income) showed a high degree of dispersion.

3.15 Early discussions were held with 14 IMs where commonality could be seen, but over time, as the detail was explored, all but four decided to drop out of the process or were discounted. There were several influencing factors for this, the most prevalent of which was capacity constraint, but also included an unwillingness to reduce fees, especially for those IMs that have a 'most favoured nation' clause in their mandates.

3.16 In summary, the launch phase will deliver nine sub-funds:

- 2 x UK passive equity
- 2 x World Developed ex UK passive equity
- 2 x Emerging Markets passive equity
- 1 x Diversified Growth Fund (hard closed but nonetheless delivering lower fees for the boroughs currently invested)
- 2 x Global active equity

3.17 In aggregate, the Phase 1 sub-funds will account for £6.1bn, or around 23% of the boroughs' total assets under management and will involve 20 of the 31 participating authorities. Total fee savings are estimated to be a minimum of £2.8 million per annum (simply through reduced IM Annual Management Charges (AMC)) but could be £3 million or more per annum based on assumptions about additional benefit derived from the tax efficient nature of the ACS Fund structure. These fee savings will not be spread equally across all the boroughs and this is largely influenced by each borough's current fee position – some boroughs have negotiated better fees than others at this point.

3.18 It should be noted that since passively managed equities generally have low fee scales, the ratio of fee savings to assets under management ("AUM") will increase as the more 'alternative' investments such as property and private equity are brought onto the fund.

3.19 In addition to the fee charged by each IM the London CIV will also apply a fee to each sub-fund as part of the company's cost recovery. These charges are applied at a rate appropriate to the nature of each sub-fund and range from 0.005% for the UK passive equity funds to 0.025% for the active funds.

Phase 2 – Establishing London CIV and developing the ACS Fund

3.20 The strategy for Phase 2, which has already commenced but with implementation starting in 2016-17, falls into two categories:

i. Revisiting the Phase I 'commonality' strategy with those IMs that had early discussions but did not progress; and

ii. Beginning the process of developing the fund with new manager selections in new asset classes.

3.21 In addition, the original nine launch sub-funds will be opened to investment from 'new' investors enabling any of the 11 boroughs (and indeed any other LGPS Fund) not included in the launch phase to transition assets from their current holdings should they wish to.

3.22 Appendix 1 attached to this report presents analysis of the boroughs' current allocation by asset class, and from this it can be seen that the major asset classes by AUM are equities (active and passive), fixed income (active and passive) and multi-asset.

3.23 Category (i) will essentially follow the same process as was described in Phase 1 and will be applied to four Multi-Asset managers and, subject to on-going discussions with IMs and potentially one further passive equity manager. The Multi-Asset products are significantly diverse, and therefore it is sensible to present a fairly wide range of choice to the boroughs so that they can select a strategy which fits their particular risk appetite and investment strategy.

3.24 Category (ii) is driven by analysis of the borough's current holdings and the need to build AUM to deliver fee income that supports London CIV's operating costs. By reference to Appendix 1 it is clear that the focus should be on targeting the remainder of the passive and active equity assets and opening initial opportunities for Fixed Income sub-funds.

3.25 Passive Fixed Income mandates will be targeted in 2Q 2016-17. Earlier data collected from the boroughs suggests that the Fixed Income asset class has little in the way of commonality and conviction, so on current projections there may be approximately £500 million being transitioned each for Active and Passive. However, the active fixed income mandates are likely to require more intensive search and selection, and therefore the bulk of the fixed income mandates will fall into the Phase 3 category.

3.26 It is anticipated that every participating borough will have opportunities to migrate to the CIV by March 2017.

3.27 As currently planned Phase 2 will conclude by March 2018. In terms of AUM, the end of Phase 2 will deliver an estimated £19 billion or 70 per cent of borough assets. However, it should be noted that the opening of sub-funds is complex and time consuming and growth at that pace cannot be guaranteed.

3.28 The CIV's first sub-fund was launched before the end of 2015. This was a relatively small active global equities fund with three boroughs currently invested with the Fund Manager - Allianz.

3.29 The London CIV's aim is to open the remaining eight sub-funds in the first quarter of 2016. The London CIV contacted the council sometime in January 2016, for the launch of two sub funds which the Fund has with Baillie Gifford to their platform. The transition of Baillie Gifford (DGF) which was £54m was completed 15th February 2016 and the transition of Baillie Gifford Global Alpha fund of some £205m has been postponed to sometime in March 2016 to allow the Irish tax office to make a decision of waiving stamp duty on the transition.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The comments of the Corporate Director of Resources are incorporated in the report. Any appropriate management fee costs relating to LBTH would be borne by the pension fund.

5. LEGAL COMMENTS

5.1 The government has issued detailed Criteria and Guidance on investment reform and pooling of local government pension funds to which the Council has responded as required. To enable Members to fulfil their statutory duties in respect of the proper management of the Council's pension fund, it is appropriate that they are kept informed of developments relating to the pooling of investment funds and collaboration with other pension fund schemes.

5.2 The Pension Committee has previously decided to manage the investment fund through the London CIV. However, this is only for the purposes of the Pension Committees duties and does not affect the application of the prevailing law relating to procurement.

5.3 For the purposes of performing activities in respect of the Pension Committee the Pension Committee has delegated the ability to act to the Council. Therefore, when determining whether or not to take advantage of purchased services the Pension Committee does so through the Council. It is the Council that is the purchaser.

5.4 Therefore, for the purposes of determining how the Pension Committee should join the LGPS framework procurement the same rules apply as if the beneficiary of the services were the Council itself.

5.5 The Council is a “Contracting Authority” for the purposes of the Public Contracts Regulations 2015 which enshrines the prevailing Procurement Law for the purposes of this report. As a contracting authority the Council and therefore, the Pension Committee must subject purchases to competitive exercises to the standard required by the Regulations.

5.6 However, in the circumstances outlined in the report it will not be the Council who is undertaking the procurement but a central government led purchasing body. Therefore, there must be adherence to certain rules to ensure that the Council and therefore the Pension Committee’s procurement obligations have been met.

5.7 It must also be considered feasible that the Pension Committee may benefit from services acquired under the framework where the London CIV itself purchases services. Again, the CIV would be considered to be a Contracting Authority for the purposes of the Regulations and certain rules must be followed to ensure that the CIV’s activities satisfy the Council’s duty to subject purchases to competition.

5.8 Therefore, in any advert for the competitive exercise for the formation of any framework from which the Pension Committee may obtain a benefit it must be clear that:

5.8.1 The London Borough Of Tower Hamlets and the Pension Committee for which it acts intends to use the procured frameworks and

5.8.2 The London Borough Of Tower Hamlets and the Pension Committee for which it acts may use the frameworks indirectly through the London CIV and

5.8.3 The London CIV may procure services through the procured frameworks.

5.9 The essence of the law in this area is to ensure that bidders have a significant amount of certainty as to who may use the procured framework and therefore, have certainty as to the potential value of services that may be available if they win the framework competition.

5.10 To give certainty potential purchasers from the framework must be “immediately identifiable” from the description of purchasers used in the advert. Therefore, it would be advisable to specifically state the above rather than use general catch all phrases such as “all London Boroughs” or such other wording.

5.11 The Council also has a duty to ensure that any purchases it makes represent Best Value for the purposes of Section 3 Local Government Act 1999. It is likely that the framework will include a number of suppliers and the Council will still have to show Best Value.

5.12 It would be usual, therefore, to include for some further competitive exercise (like a mini-tender) once the specific requirements are understood for the purchase of the services each time.

5.13 However, it should be noted that in any event a purchase from a single provider under a framework is only allowable (notwithstanding the rules set down in the framework itself) where the Council can show that the particular supplier presented the best value bid during the competitive exercise under which the framework was originally created. Otherwise, there can be no demonstration of Best Value.

5.14 Once the frameworks have been created subsequent purchases from the frameworks should be still subject to the approvals requirements set down in the Council's Constitution.

5.15 When deciding whether or not to proceed with a project, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty).

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.

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

7. BEST VALUE (BV) IMPLICATIONS

7.1 To have an efficient, cost reduction platform for investment management of the fund by pooling and collaborating is considered to be a good decision which can result in greater cost savings to the fund.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

9. RISK MANAGEMENT IMPLICATIONS

9.1 The rigorous robust management of LBTH Pension Fund results in better quicker and more effective decision making which can lead to better Fund performance and reduction in the contribution required from the Council towards the Fund. The monitoring arrangement for the Pension Fund and the work of the Pensions Committee should ensure that the Fund optimises the use of its resources in achieving the best returns for the Council and members of the Fund.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

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

Linked Reports, Appendices and Background Documents

Linked Report
- NONE

Appendices
- Appendix 1 – Analysis of boroughs holdings as at 31 March 2015

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report
- NONE

Officer contact details for documents:
- Bola Tobun - Investment &Treasury Manager x4733
- Mulberry House, 5 Clove Crescent E14 2BG

Appendix 1: Analysis of current borough holdings

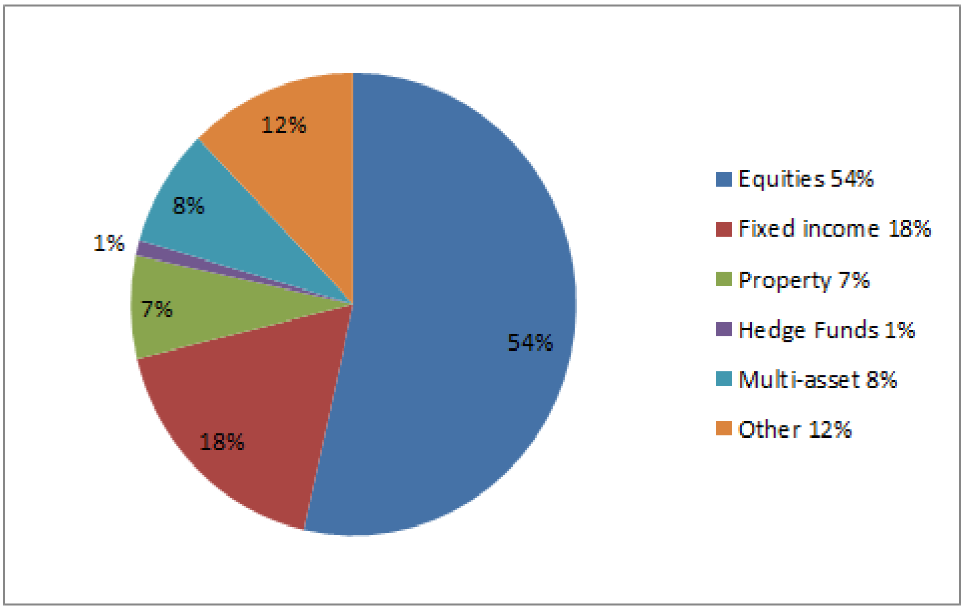
<u>Current asset allocation</u>

The breakdown of the pension fund assets as of 31 March 2015 for the 31 participating London boroughs can be seen below:

Table 1

Allocation	£m, March 2015	Percentage
UK equities	5,077.39	18.9%
overseas equities	6,560.63	24.4%
unallocated	2,748.31	10.2%
total equities	**14,386.33**	**53.6%**
UK fixed interest	2,636.29	9.8%
overseas fixed interest	808.32	3.0%
unallocated	863.04	3.2%
total fixed interest	**4,307.65**	**16.0%**
UK index linked	312.52	1.2%
overseas index linked	30.01	0.1%
unallocated	80.43	0.3%
total index linked	**422.96**	**1.6%**
UK property	1,350.87	5.0%
overseas property	56.85	0.2%
unallocated	517.01	1.9%
total property	**1,924.73**	**7.2%**
UK hedge funds	32.40	0.1%
overseas hedge funds	-	0.0%
unallocated	256.56	1.0%
total hedge funds	**288.96**	**1.1%**
UK other	783.74	2.9%
overseas other	963.62	3.6%
Multi-asset	**2,214.31**	**8.2%**
Total unallocated	**3,961.67**	**14.8%**
infrastructure	193.53	0.7%
commodities	57.43	0.2%
private equity	525.05	2.0%
derivatives	- 2.28	0.0%
currency overlay	-	0.0%
cash	777.37	2.9%
Total investment assets	**26,843.38**	**100.0%**

NB the multi-asset allocation is done on a “best efforts basis” due to conflicting and out of date data.


12%
8%
1%
7%
54%
18%
Equities 54%
Fixed income 18%
Property 7%
Hedge Funds 1%
Multi-asset 8%
Other 12%