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| <b>Cabinet</b><br>23 July 2014  | <br><b>TOWER HAMLETS</b> |
| <b>Report of:</b> Chris Holme, Acting Corporate Director of Resources | <b>Classification:</b><br>Unrestricted  |
| <b>The London LGPS Collective Investment Vehicle (CIV)</b>            |   |

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| <b>Lead Member</b>            | Cabinet Member for Resources. Cllr Alibor Choudhury                          |
| <b>Originating Officer(s)</b> | Bola Tobun, Investment and Treasury Manager<br>Kevin Miles, Chief Accountant |
| <b>Wards affected</b>         | All  |
| <b>Community Plan Theme</b>   | One Tower Hamlets  |
| <b>Key Decision?</b>          | No   |

## 1. **SUMMARY**

- 1.1 In 2013 the 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 In an attempt to reduce pension fund investment management costs, the creation of a London LGPS Collective Investment Vehicle (CIV) is being made through London Councils. The vehicle would allow pension fund investments to be pooled for the purpose of reducing fund managers' fees.
- 1.3 At the moment, the scheme is in its early stages of development. This report asks the Cabinet to agree to the Council participating in the establishment of a Collective Investment Vehicle (CIV) in London. The establishment of this vehicle will enable Pension Funds in London, including the London Borough of Tower Hamlets 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.

## **2. DECISIONS REQUIRED**

The Mayor in Cabinet is recommended to agree:

1. To participate in the establishment of the London (LGPS) Collective Investment Vehicle (CIV)
2. 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. That following the incorporation of ACS Operator, the London Borough of Tower Hamlets:
  - 2.3.1 become a shareholder in the ACS Operator.
  - 2.3.2 contribute £1 to the ACS Operator as initial capital;
  - 2.3.3 appoint an executive member to exercise the Council's rights as shareholder of the ACS Operator;
4. 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
5. 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.

## **3. REASONS FOR DECISIONS**

- 3.1 The London Borough of Tower Hamlets is the Administering Authority of the London Borough of Tower Hamlets Pension Fund and has the delegated responsibility for decisions regarding the Pension Fund to the Pensions Committee.
- 3.2 There is pressure on LGPS funds to demonstrate efficiency savings and work collaboratively. This decision would enable LBTH 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.

## **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 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 is currently planned that the scheme will be launched in February 2015, though this date may slip to a later date 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 Collective 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 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.
- 5.7 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 £1 to become a shareholder in the venture and establishing a management structure. The decisions required are in relation to executive functions.

## **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. 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 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.
- 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 Appendix A, paragraph 43 of the progress report attached to see details of the costs and potential savings.

## **8. INVESTMENT IN THE ACS COLLECTIVE INVESTMENT VEHICLE**

- 8.1 To take part in the ACS Collective 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 which 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 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.

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 Collective Investment Vehicle appears to be a viable way to achieve savings.

10.3 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.

10.4 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 the Mayor in Cabinet to make them.

10.5 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.

10.6 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 non-executive Members may be appointed. Notwithstanding where the functions to be exercised are entirely executive it would be most appropriate to appoint an executive member.

## **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.

### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

NONE

#### **Appendices**

- NONE

#### **Background Documents – Local Authorities (Executive Arrangements)(Access to Information)(England) Regulations 2012**

NONE