

For General Release

REPORT TO:	COUNCIL 24 MARCH 2014
AGENDA ITEM:	13
SUBJECT:	LONDON LOCAL GOVERNMENT PENSION SCHEME FUND COLLECTIVE INVESTMENT VEHICLE
LEAD OFFICER:	RICHARD SIMPSON DIRECTOR OF FINANCE AND ASSETS
WARDS:	ALL
CORPORATE PRIORITY/POLICY CONTEXT: Sound Financial Management: the Pensions Committee provides guidance for the management of the Pension Fund to secure optimum investment performance and value for money.	
FINANCIAL IMPACT: There are financial consequences for the Pension Fund relating to the recommendations contained within this report. Depending on take up, significant fee reductions from investment managers can be expected.	
KEY DECISION REFERENCE NO.: This is not a key decision.	
1. RECOMMENDATIONS 1.1 That Full Council: (a) Agree that the Council 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 Common Investment Vehicle; (b) Contribute £1 to the ACS Operator as initial capital; (c) Delegate to the Director of Finance and Assets, in consultation with the Chairman of the Pensions Committee, authority to take such further steps as are necessary to implement the Council's participation in the Common Investment Vehicle and to act for the Council in exercising its rights as a shareholder of the ACS Operator; and (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.	

2. EXECUTIVE SUMMARY

- 2.1 This report provides background and details the proposal by London Councils to establish a collective investment vehicle. It recommends that this authority commit to being a founder member of this vehicle by participating in a new London Councils Joint Committee.

3. DETAIL

- 3.1 The Pension Committee has, for several years, actively engaged with fund managers in order to drive down investment costs that are related to the investment of the assets of the Croydon Local Government Pension Scheme (LGPS) Pension Fund (the Fund). However there is a limit on the savings that individual authorities can achieve because of the size of single investments, either direct or into pooled funds. Although there is no compelling evidence to suggest that larger pension funds consistently generate any better results than small or medium-sized funds, larger funds are able to allocate more resources to the investment process and clearly they are able to access more favourable fee structures. Recognising these factors DCLG launched a call for evidence on the future structure of the LGPS, to which this authority responded as part of a group of London boroughs. One way forward has been to explore the potential of some sort of Collective Investment Vehicle (CIV), a legal structure currently utilised by international or grouped businesses to allow the different components of a large entity to pool pension investments. Members of the Pensions Committee have been briefed on the progress of this initiative, which has been lead and directed by London Councils. London Councils Leaders' Committee approved the formation of the CIV on 11th February, and the Terms of Reference on the 11th March, so it is necessary for the Council to formally consider now whether to join the CIV company and participate in a new Joint Committee.
- 3.2 London Councils Leaders' Committee 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, a proposed governance structure and terms of reference. They have also approved that a London 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.
- 3.3 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 the ACS Operator (which is the company that would manage the ACS). For this to occur, London boroughs would need to agree to become shareholders in the ACS Operator and delegate oversight of the company to a Joint Committee hosted by London Councils.
- 3.4 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.

- 3.5 The business case considered by London Councils analysed the savings, benefits and costs for a variety of different levels of collective assets under management: £24 billion, £10 billion and £5 billion, producing estimated annual net savings of £112.2 million, £44.9 million and £20.9 million respectively. It is considered that a reasonable minimum target size of assets under management for the ACS is in the range of £5 billion. 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. This aligns with the revised investment strategy for the Croydon Pension Fund.
- 3.6 London Councils Leaders set out the likely Governance structures and key principles for the CIV. 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).
- 3.7 This Joint Committee will 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 Councillors nominated by participating boroughs as provided for under the existing London Councils Governing Agreement. It will allow the local authorities to streamline their decision making by delegating responsibility for decisions to the Joint Committee, rather than requiring decisions from the individual local authorities. 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, as in the event that meetings are required to deal with specialist matters, for instance discussions on investment matters such as the setting of original investment mandates by the ACS Operator (which is an FCA responsibility of the ACS Operator), a person with appropriate expertise, such as expertise in investor matters would be needed. In the event that all 33 boroughs decide to join then the CIV then the Leader could fulfil this role, through the existing London Councils Leaders Committee.
- 3.8 In order that the Council can participate in the CIV the Council will need to agree to join the Joint Committee and this requires a resolution of the full Council. In addition the Council will need to formally delegate powers to the Joint Committee

in respect of pensions investments. This will be done by giving the Pensions Committee the ability to place funds with the CIV and to invest in one or more of the funds or fund managers selected by the CIV to manage various asset classes. To cover any executive functions that might be engaged it is intended that these proposals also be approved under a delegation from the Leader of the Council to the Chief Executive in consultation with the Chairman of the Pensions Committee.

- 3.9 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.

Recommendation

- 3.10 To achieve the above arrangements it will be necessary to:
- (a) 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 Common Investment Vehicle and Contribute £1 to the ACS Operator as initial capital;
 - (b) Delegate to the Director of Finance and Assets, in consultation with the Chairman of the Pensions Committee authority to take such further steps as are necessary to implement the Council’s participation in the Common Investment Vehicle and to act for the Council in exercising its rights as a shareholder of the ACS Operator, and ;
 - (c) 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.

4. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION

- 4.1 The adoption of this proposal will allow the Council, as administrating authority for the LGPS, to potentially drive down the costs of investing the assets of the Pension Fund. This will, in the long run, improve the returns achieved and help control the costs to the authority as a Scheme employer and to other employers for whom the Council is the Scheme administrator.

5. ANY OPTIONS CONSIDERED AND REJECTED

- 5.1 This option is one of a number of strategies that are being employed to drive down investment costs, including negotiation with fund managers, more aggressive contract manager and effective procurement methods.

6. FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

- 6.1 There are financial consequences for the Pension Fund relating to the recommendations contained within this report. Depending on take up, significant fee reductions from investment managers can be expected.

7. COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

- 7.1 The Council Solicitor comments that to inform the local authorities in taking their decision as to whether to participate in the arrangements, legal advice regarding the set-up of the proposed ACS, the ACS operator and some associated considerations was commissioned from Eversheds Solicitors by London Council's.
- 7.2 In summary, and based upon the intention that two UK based FCA authorised entities are set up: the investment fund itself (the "ACS") and the entity which operates this, the ACS Operator, with a joint committee to act as a representative body on behalf of the participating local authorities, they have advised as follows.
- 7.2.1 Those local authorities who contribute capital to the ACS Operator will be shareholders of the ACS Operator and have typical shareholder rights e.g. around the approval and appointment of directors and others as agreed between the shareholders.
- 7.2.2 The Joint Committee will be set up by the local authorities using their powers in sections 101 and 102 of the Local Government Act 1972 and section 9EB of the Local Government Act 2000. The Joint Committee will need to have terms of reference which set out its powers and the functions for which it is responsible (i.e., the functions relating to acting as a representative of the shareholders in the ACS Operator). The terms of reference will be agreed in accordance with the Governing Agreement of London Councils which established Sectoral joint committees which made provision for additional Sectoral joint committees to be established.
- 7.2.3 While there is an inherent conflict of interests where representatives of the Borough Pensions Committee sit on the Joint Committee, as they will be both shareholder representatives of the ACS Operator and also make decisions on investments into the ACS itself, this conflict can be managed in the terms of reference of the Joint Committee and the conflicts policy of the ACS Operator which is required by the FCA.
- 7.2.4 The ACS Operator will be set up as a company with the intention that it trade for commercial return using the powers in sections 1 and 4 of the Localism Act 2011. Based upon the above report and the advice received it may be considered that the proposals in this report represent a reasonable exercise of this power.
- 7.2.5 Once established the Joint Committee would be collectively acting in the interests of all participating authorities in exercising their rights as shareholders of a company. Additionally, councillors or officers whom the local authorities nominate to serve as directors of the ACS Operator (if any) would be obliged to act in the best interests of the company and they would need to be satisfied that there would not be a conflict of interests when they balance this duty with their role as a councillor or officer of the local authority that nominates them as a director.
- 7.2.6 The key functions for which the ACS Operator will be responsible are:
- Investment management of the portfolio of assets of the ACS;
 - General administration functions;
 - Risk and compliance functions.

Where any functions are delegated / outsourced, the ACS Operator needs to be able to demonstrate to the FCA that it can supervise such delegations.

7.2.7 The directors of the ACS Operator and those people who perform certain key functions (the chief executive, compliance officer, the money laundering officer, customer function, potentially client assets officer) have to be approved by the FCA and the performance of the functions carries personal responsibility. The ACS Operator will need to obtain initial FCA authorisation and will then be subject to on-going FCA compliance and supervision.

7.2.8 The decision to invest through the ACS in the future, as well as the size of investment and mix of assets, will remain with each Borough Pensions Committee.

7.2.9 Since it is expected that the ACS Operator would be wholly owned by the local authorities that intend to receive services from it and that it would be established to provide such services, it would be expected that the arrangement would be able to come within the scope of the “Teckal” exemption such that the usual public procurement compliance requirements should not apply. .

8. HUMAN RESOURCES EQUALITIES, ENVIRONMENTAL, CRIME AND DISORDER REDUCTION IMPACTS

8.1 There are no direct implications in these areas arising from this report.

9. FREEDOM OF INFORMATION (FoI) / DATA PROTECTION CONSIDERATIONS

9.1 There are no specific Data Protection considerations arising from this report.

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BACKGROUND PAPERS: None