Report for: Pensions Committee 14th January 2016

Item number: 11

Title: London Collective Investment Vehicle

Report authorised by: Tracie Evans, Chief Operating Officer (CFO)

Lead Officer: George Bruce, Head of Finance - Treasury & Pensions
George.bruce@haringey.gov.uk 02084893726

Ward(s) affected: N/A

Report for Key/ Non Key Decision: Non Key decision

1. Describe the issue under consideration

1.1 This paper was discussed at the 19th October 2015 training meeting. As no decisions can be made at a training meeting, the paper is resubmitted so that a formal decision can be made.

1.2 The London CIV has been established to facilitate the collective management of London LGPS investments. Almost all the London Boroughs, including Haringey, have contributed £75,000 towards the set up costs. Boroughs have now being asking if they wish to invest through the CIV and estimates of the impact on investment management costs have been provided.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 That the Committee:

(a) Agree to transfer the management of listed equities <u>excluding</u> emerging markets to the London CIV noting that ultimate management will remain with Legal & General, and

(b) Delegate authority to the Chief Operating Officer (CFO) or in their absence the Head of Finance – Treasury & Pensions authority to execute any documents required to complete the transfer of assets to the London CIV.

4. Other options considered

4.1 The paper considers the two options of investing through the London CIV or maintaining the current direct relationship with Legal & General.

5. Background information

5.1 The Committee has supported the establishment of the London CIV through a contribution of £75,000 towards its establishment costs and at the September 2015 meeting agreed to contribute share capital as required to a maximum value of £150,000.

5.2 The CIV has now received regulatory approval from the FCA to act as a collective manager. It has reached fee agreements with four fund managers - Legal & General, BlackRock, Allianz (active equity) and Baillie Gifford (DGF). It is now asking boroughs to indicate their willingness to transfer assets to the CIV.

5.3 Of these four managers, only one is relevant to Haringey, L&G, and only in respect of equities. However, that does represent over 60% of the fund, circa £600 million. Initially the Index Linked Gilts (ILG) gilts will remain directly invested with L&G, who have confirmed that the current 3 bps fees will remain.

5.4 In considering whether to switch assets to the CIV, the Committee should consider:

- The financial implications, balancing ongoing fees and one of initial costs.
- The impact on the quality of the fund management and the anticipated returns.
- The ability to have a dialogue with the fund manager and influence its behaviour e.g. voting and corporate engagement.
- Whether investing through the CIV will add to or reduce future investment options.
- Meeting the expectation of government.

Each of these issues is considered below.

<u>Financial Implications</u>

5.5 The fee and cost schedules prepared by the CIV and verified with L&G indicate an initial annual net benefit of £15,000 from using the CIV based on its assumed starting asset base. The savings largely arise from enhanced tax recoveries within the CIV structure. The CIV fees will also fall as its asset base grows. There will be a one off cost linked to the transfer of assets and that is estimated as £360,000 to £400,000. The transition costs are substantial and will take many years to recoup from annual fee savings.

5.6 An alternative to improve the financial outcome will be to retain Emerging Market equities in the current direct ownership structure and only move developed market equities to the CIV. This will lead to annual fee savings of £113,000 and reduce one off transition costs to £26,000, a clear financial benefit, which justifies utilizing the CIV.

Changes in anticipated returns and the quality of investment management

5.7 The equities will remain invested passively with Legal & General and therefore the anticipated returns will be unaffected. However, the CIV will not permit bespoke regional allocations to non UK developed equities, instead will be using an ex UK world index. This will result in small changes to the non UK equity allocations, the largest being a £10 million increase in the US equity allocation. Using a world equity index rather than fixed regional allocations will introduce a little more volatility into the portfolio.

Dialogue and Influence with Fund Managers

5.8 Investing though the CIV will mean that L&G will be appointed by and report to the CIV. Major decisions regarding changing asset classes or manager will remain with Haringey, but our ability to influence L&G e.g. in voting or corporate engagement will be reduced.

Impact on future investment options

5.9 The CIV is in the initial stages of development and over time can be expected to increase its range of asset classes. Should the Committee wish to consider changes to the current equity structure e.g. alternative indices such as those omitting particular industries (tobacco) that will not initially be available through the CIV. This will reduce future flexibility but with the option to remove assets from the CIV if necessary at minimal cost.

Meeting the Expectations of Government

5.10 The recently issued pooling criteria (separate item on the agenda) requires all LGPS funds to submit proposals aimed at forming collective pools each with approximately £30 billion of investments. Funds that do not pool assets voluntarily are likely to be forced to do so. Haringey pooling developed market equities through the CIV, which represent over 50% of our total assets, will be seen as positively responding to the Governments wishes and create some room to work out the best arrangements for the remainder of the fund.

Conclusion

5.11 Taking into consideration all these factors, the balance favours transferring listed equities excluding emerging markets to be invested in L&G through the CIV.

6. Comments of the Chief Financial Officer and financial Implications

6.1. The proposal to use the London CIV to manage passive developed equities will result in a small fee savings without materially disturbing the current management arrangements. More challenging decisions will follow when pooling arrangements for the other asset classes have to be considered.

7. Comments of the Assistant Director of Corporate Governance

7.1 The Assistant Director of Corporate Governance has been consulted in the preparation of this report, and makes the following comments.

7.2. Whilst the Pensions Committee has the Constitutional authority to adopt the Recommendations contained in this report within its terms of reference, it is under a legislative duty to take "proper advice in relation to the appointment [of an investment manager]". The objective to be achieved, is – in summary - to illicit an assurance that there are reasonable grounds to believe that the proposed investment manager has the requisite level of ability and practical experience to make decisions on behalf of the administering authority.

7.3. The duty is discharged by reference to the terms of paragraphs 5.2 - 5.3 and 8.1- 8.5 of the report.

8. Comments of the Independent Advisor

8.1 In the July 2015 Budget the Chancellor of the Exchequer announced that "The Government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance." In November 2015 the DCLG issued a document entitled "Local Government Pension Scheme: Investment Reform Criteria and Guidance." This paper sets out the Government's criteria and guidance for the establishment of Asset Pools to undertake the investment of Scheme assets on behalf of the 89 individual LGPS Funds in England and Wales. The Government envisages the creation of up to six Pools each with assets of at least £25billion.

8.2 London LGPS Funds have been working together to develop a Pool known as the London CIV (Collective Investment Vehicle). The London CIV has now reached agreement with four asset managers for the voluntary transfer to the CIV of certain assets managed by those managers should an individual London LGPS Fund so wish. In the case of Haringey this option is available in respect of its Listed Equities managed by L&G.

8.3 In addition to the expectation of Government that individual Fund assets will be progressively transferred to collective investment arrangements there is a clear financial case for the transfer to the London CIV, at this stage, of the Funds Listed Equities but excluding its Emerging Market Equities. Based on costings that I have examined there would be a potential £113,000 per annum saving in transferring the Funds non Emerging Market Equities to the London CIV. I have been informed that the associated one off transition costs are only £26,000.

8.4 If the Emerging Market Equities were also transferred, at this time, the potential annual saving could be only £15,000 in total. This is because of both the CIV fee structure and adverse tax implications associated with the management of the Emerging Markets Listed Equities portfolio by the CIV. Also, I understand, there would be a total one off transition cost (for the entire Listed Equity portfolio) of £360,000 to £400,000.

8.5 Therefore there are clear financial grounds for transferring the Listed Equities portfolio, with the exception of the Emerging Markets element, to the London CIV.

8.6 With regard to future transfers of other Fund assets to a Pooling arrangement it should be noted that other Pools are under development across the LGPS including some involving the large internally managed LGPS Funds who have significant existing in house expertise in both the direct management of assets and the appointment and monitoring of a wide range of asset managers including significant experience of alternative assets

9. Equalities and Community Cohesion Comments

9.1 The Local Government Pension Scheme is a defined benefit open scheme enabling all employees of the Local Authority to participate. There are no impacts in terms of equality from the recommendations contained within this report.

10. Head of Procurement Comments

9.1 Not applicable

11. Use of Appendices

11.1 None.

12. Local Government (Access to Information) Act 1985

12.1 Not applicable.