Report No.
RES13170

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee**
Date:	**18th September 2013**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**LONDON-WIDE COLLABORATIVE INVESTMENT VEHICLE**
Contact Officer:	Peter Turner, Director of Finance Tel: 020 8313 4338 E-mail: peter-turner@bromley.gov.uk
Chief Officer:	Director of Finance
Ward:	All

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1. Reason for report

This report updates Members on various pension matters and on the wider public debate relating to the possibility of merging Local Government Pension Funds.

RECOMMENDATIONS

The Sub-Committee is asked to:

2.1 Note the general update on other pension matters detailed in paragraph 3.1;

2.2 Note the update on the wider public debate relating to the possibility of merging Local Government Pension Funds;

2.3 Agree that greater collaborative working be progressed relating to participation in a London Collaborative Investment Vehicle (CIV);

2.4 Authorise the Director of Finance to undertake further due diligence on the establishment of a London wide CIV including contributing up to £25,000 from the Pension Fund to meet legal and setting up costs of the CIV.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits. Annual report required to be published under LGPS (Administration) Regulations 2008.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost

2. Ongoing costs: Recurring cost. Pension Fund audit fee £21,000 in 2012/13. Total fund administration costs £1.9m in 2012/13 (includes audit fee, fund manager/actuary/external advice fees, Liberata charge and officer time)

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £35.0m expenditure (pensions, lump sums, etc); £38.8m income (contributions, investment income, etc); £582.4m total fund market value at 30th June 2013)

5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.4 fte (current)

2. If from existing staff resources, number of staff hours: c14 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2007 and LGPS (Administration) Regulations 2008

2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 4,996 current employees; 4,777 pensioners; 4,538 deferred pensioners as at 30th June 2013

Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.

2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

General Update

3.1 There was a Member seminar on pension matters in February 2013 with presentations by the Director of Finance, the Council's new actuary Mercer and Baillie Gifford which are available on the Council Members' website. The main developments reported included:

(a) Phased implementation of auto enrolment;
(b) The planned changes to the LGPS from April 2014;
(c) Government proposals on councillors' pensions;
(d) Changes to governance requirements;
(e) The actuarial triennial valuation due later this year which impacts on the Council's contribution to the Pension Fund for 2014/15 to 2016/17;
(f) Wider debate about the merging of pension funds, compared with the status quo position and an option considering the use of a CIV hosted by one organisation.

A verbal update on the matters identified in (a) to (e) will be provided at the meeting. This report focuses specifically on item (f).

Option of a Merger of London Pension Funds

3.2 Proposals for a London Pensions Mutual were originally drawn up by the London Pension Fund Authority (LPFA). In a subsequent interview with the Financial Times in February 2013, the new LPFA Chairman, Edward Truell, announced plans to merge all the London funds under the LPFA.

3.3 In June 2013, the Mayor of London called on London's pension funds to invest in property and infrastructure in London. "We need to mobilise the pension funds to build in London - and especially new homes for rent" as indicated in the Mayor's "Vision for 2020" document.

3.4 The LPFA proposal reflects their view that the merged scheme would be more efficient compared with operating as separate smaller funds. It is also argued that the larger funds would have lower administration costs and better returns. Although there may be a case for lower administration costs there is inconclusive evidence to support the argument about better returns. Bromley, for example, is a smaller fund which has achieved excellent returns.

3.5 The proposal suggested by the LPFA indicates that deficits should remain a local liability. The Council's Pension Fund has had strong performance with a funding level of 84% at the last full valuation as at 31 March 2010 - any underperformance as part of a bigger fund would result in costs to council tax payers. The performance could be affected as the merger of funds could lead to a more risk adverse approach to investments which, in the longer term, may reduce lower returns with ultimate cost implications for meeting the Council's pension fund deficit level and future pension costs.

3.6 The Chairman of the Sub-Committee recently wrote to Brandon Lewis expressing his concerns giving the reasons for opposing a forced merger, referring to the unproven case made by LPFA and to significant potential costs which would not be in the Council's financial interest.

Review of Pension Funds in London

3.7 Last year, London Leaders (London Councils) commissioned work through the Society of London Treasurers to explore options for London. The five challenges identified by the Society of London Treasurers are shown below:

1) The responsibilities of each London Borough towards the pensioners in minimising risk and maximising returns for their funds delivered through the Trustee responsibilities of each Member of Pension Committee in accordance with the Myners principles;
2) The need for local decision making in relation to asset allocation;
3) The recognised relationship between local decision making in relation to the fund and its associated returns and deficit and local taxation implications;
4) The statutory responsibilities of local authorities in relation to actuarial valuations and pension fund accounts and audit requirements;
5) The political and managerial ownership of the decisions in relation to the pension fund, its associated costs and the need for influence over decision making.

The overarching theme is local accountability.

3.8 PWC were also commissioned in October 2012 to undertake work on various options for London and recommended that "Collective Investment Funds can fully meet the five challenges identified by the Society of London treasurers". Local accountability would remain, with investment manager interactions delegated to a central entity. They identified that individual London LGPS Funds have assets in the range of £0.4 billion to £1.0 billion. They reported that a potential disadvantage of a Collaborative Investment Fund structure would be that economies of scale may not be achieved if there was low participation. As part of that report, PWC compared the annualised investment return for each London borough over a 10 year period to 2011 – Bromley was identified as having the highest level of performance.

3.9 All three Leaders of the political parties at London Councils were drawn to the CIV model. At its May 2013 meeting, London Councils Leaders' Committee agreed to commission the working group to undertake further work and report back on the issues that would need to be addressed in setting up any future CIV.

3.10 The Leaders Committee also agreed in principle to move towards a CIV for those interested boroughs, subject to Leaders Committee consideration of the outcome of further work by the Working Group, A further report will be submitted to the Leaders Committee in the autumn. In the event that London Councils decide not to proceed with a CIV, there is still sufficient support for a lead borough arrangement to operate a CIV.

Collaborative Investment Vehicle (CIV)

3.11 The main benefits of a CIV, which would be undertaken by one organisation on behalf of other local authorities, are summarised below:

(a) Fees can be negotiated down using the CIV, which would be particularly more favourable in alternative class investments;
(b) It preserves individual boroughs' decisions on funding strategy and asset allocation - there is no risk of some schemes subsidising others;
(c) Reduces costs by buying investment management services in bulk;
(d) There are some small funds that outperform – this approach will not prevent this from continuing;

(e) Would more easily facilitate the early investment in emergent asset classes with respective economies of scale not being possible through a single fund;
(f) A full merger would blur actuarial valuations – high deficit and low deficit funds would have different investment strategies – CIV would allow alternative investment strategies to continue ;
(g) CIV would operate using a "best of breed" selection of funds/managers for each asset class. Day to day governance, due diligence etc would be undertaken by the CIV;
(h) Boroughs are free to choose any managers from CIV – they are not compelled to choose a CIV manager. It is hoped that as "best of breed" managers they would be clearly beneficial to choose.
(i) There would continue to be well defined segregated mandates , with the CIV using its buying power to secure lower investment manager fees;
(j) The CIV would enable early investment in emergent asset classes;
(k) Potential to, in future, provide any officer- related investment duties that boroughs wished to delegate – this could extend to preparing committee reports, using a common custodian , preparation of accounts etc;
(l) Achieves benefits of "size" without the upheaval.

3.12 Maintaining an individual approach to tendering and investment is not realistically an option for the medium and longer term. The CIV is expected to reduce costs and enable the choice of better performing fund managers. New asset classes would be explored including, for example, infrastructure.

3.13 Boroughs would retain their own custodian, control over asset allocation and accounting responsibilities. At each triennial valuation, local authorities will continue to review and agree their updated Funding Strategy and Strategic Asset Allocation and Statement of Investment Principles.

3.14 To date, collaboration in London has mainly focused on administrative functions rather than on investment activity. To provide savings to the pension fund, Bromley has outsourced the payment of pensions and we appoint fund advisor and actuary through competitive tender processes. Outsourcing already permits economies of scale – it therefore delivers cost effectiveness in this area.

3.15 The LPFA have been very active in progressing a merger of pension funds and have indicated that the CIV option needs to go further to include:

(a) management of liabilities;
(b) pool administration in order to provide real time data for liability management and cost savings;
(c) Concede asset allocation to the CIV manager.

3.16 Bromley has historically achieved higher returns than other pension funds through its asset allocation decisions which would be lost if the LPFA proposal was implemented.

Pension Fund Deficit

3.17 In a presentation to pension fund managers, the LPFA explicitly suggests that deficits would remain a local liability. There remains a risk that merging deficits, and inherent risk of cross subsidisation, could be considered at a later stage but that would take a considerable number of years. Therefore, the pooling of pension fund deficits does not appear to be a short or medium term risk.

Call for Evidence on the Future Structure of the Local Government Pension Scheme

3.18 On 16 May, the Local Government Association (LGA) and DCLG held a roundtable event on the potential for increased co-operation within the LGPS, including the possibility of structural change to the current 89 funds. A "Call for Evidence on the future structure of the Local Government Pension Scheme" was subsequently issued by the LGA and the Department of Communities and Local Government (DCLG) for response by 27 September 2013.

Next Steps

3.19 An analysis of comparative data is awaited prior to finalising Bromley's response to the call of evidence which will be undertaken by the Director of Finance in consultation with the Chairman of the Pensions Investment Sub Committee.

3.20 Wandsworth are willing to be a host borough for a London-Wide collective Investment Vehicle if required. They will require a contribution of up to £25k towards the set up costs but anticipate that the CIV ongoing costs will be self financing through negotiating reduced management fees with fund managers. Any costs would be met by the Pension Fund. The Pensions Investment Sub-Committee is requested to consider expressing an interest in joining the CIV and in contributing to the set up costs which would be financed from the Pension Fund.

3.21 With a CIV arrangement, each pension committee could choose whether to use a fund manager from the CIV or retain its current managers or use a combination of both e.g. use CIV to diversify into alternative asset classes such as infrastructure with respective economies of scale not being possible through a single fund.

Conclusion

3.22 There are a significant number of developments impacting on LGPS at the present time. In terms of any merger of funds there is no conclusive evidence that larger pension funds will perform better – greater collaboration is key for the future. Many of the best performing pension funds in the longer term have been the smallest, including Bromley. There remain potential savings that could be made through collaboration without the need for costly and complex mergers. Asset allocation remains fundamental to improving investment returns and the CIV allows local asset allocations to continue. There is no doubt that sharing services will enable managers to aggregate fees. Members are requested to consider the formation of a CIV, hosted by Wandsworth Council which will require a financial contribution of up to £25k to support the set up costs. These costs would be met from the Pension Fund and any further costs of the CIV are expected to be self financing through negotiating reduced management fees with fund managers.

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits. An Annual Report is required to be published under LGPS (Administration) Regulations 2008.

5. FINANCIAL IMPLICATIONS

5.1 A contribution of £25,000 towards the set-up costs of a CIV would be met from the Pension Fund Revenue Account.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	LGPS Regulations 2007 & LGPS (Administration) Regulations 2008.