Pensions CIV Sectoral Joint Committee

Item no: 8

Review of Benefits

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Summary	This paper updates an earlier paper provided to the Joint Committee on the benefits to be delivered to Local Authority Pension Funds from the Collective Investment Vehicle. The benefits paper circulated in February 2015 was in advance of the Government's Criteria and Guidance issued in November 2015.

Recommendations	The committee is recommended to: i. Note the contents of this report;

London CIV Review of Benefits

Introduction

1. At its meeting in February 2015 the Committee was presented with a report on the operating budget and benefits of the CIV which covered a range of cashable and non-cashable benefits to investors and stakeholders. At the Pensions Joint Committee AGM in June 2016, it was agreed that a further exploration of the benefits would be presented to the autumn meeting of the Joint Committee. This paper sets out to update the Committee on the benefits being delivered and those still being worked on.

Cashable Benefits

<u>Investment Manager Fee Reductions</u>

2. Since the benefits paper was produced, the London CIV has obtained FCA registration and opened 5 sub funds (2 global equity and 3 multi-assets). Assets under management by mid-September were just over £2.5bn with 14 London Funds invested. This is delivering just under £1m net of annualised fee savings. These have been calculated taking into account each London Fund's assets under management, the fee scales pre and post transition and include the costs associated with the London CIV charges including asset servicer and custody costs.
3. In addition, the London CIV expended considerable efforts in negotiating with the largest passive manager for London Funds and whilst this has not resulted in sub-funds for the CIV, it has delivered significant savings benefits to the invested funds. Fourteen funds were invested with Legal & General in their passive life funds and as a result of the centralised negotiations with the CIV, annualised savings of £1.85m net will have been achieved. These have been calculated taking into account each London Fund's assets under management, the fee scales pre and post transition and include the costs associated with the London CIV charges including asset servicer and custody costs.
4. With a further sub-fund due to open in December this will again increase the value of annualised savings by a further £0.37m net. Additional sub-fund openings based on current negotiations with managers could see 2-3 more sub-funds opening and on a conservative estimate, this could add close to £1m of further annualised savings to invested boroughs. These have been calculated taking into account each London Fund's assets under management, the fee scales pre and post transition and include the costs associated with the London CIV charges including asset servicer and custody costs.
5. In aggregate anticipated annualised fee savings from opening sub-funds since FCA registration to the end of the 2016/17 financial year could amount to annual savings for invested London Funds of £2.56m net on assets under management of £4.26bn. If savings from the largest passive manager of London Pension Funds is included then the benefits delivered on an annual basis could amount to £4.4m net. The CIV are hopeful the negotiations underway with the second largest provider of passive funds and a further global equity manager will deliver further savings to investors during the current financial year. These have been calculated taking into account each London Fund's assets under management, the fee scales pre and post transition and include the costs associated with the London CIV charges including asset servicer and custody costs.

6. Members will note that there is an additional Committee paper on the global equity procurement and whilst it is unlikely to deliver new sub-funds until the financial year 2017/18, the potential to add value from this procurement exercise against standard institutional fees could be significant when reflecting on proposed fees being put forward as part of the tender process.

Tax Benefits

7. The benefits paper from February 2015 set out additional tax benefits which could be available when investing through the CIV ACS and these will vary considerably depending on the starting point of the individual funds invested. Little work has so far been undertaken on the actual tax benefits achieved, but is likely to be the subject of further work, to demonstrate value adds in this area.

Procurement Savings

8. As Members will be aware, to date the London CIV has concentrated efforts on opening sub-funds on the basis of a CQC approach, thereby undertaking transitions of existing managers on to the CIV platform.

9. The global equity procurement is the first where new managers are being sought via a procurement route (this may indeed include existing managers for some London Funds). The analysis referred to in the February 2015 paper showed over the three years 2010 to 2013 that there were 99 mandate changes made by London Pension Funds (an average of one mandate change per fund per year). The assumption that generally a mandate change incurs procurement related costs of around £50,000 and that going forwards where the CIV was undertaking procurement on behalf of the London Funds then savings over an 18 month period could amount to £500,000. The current global equity procurement has looked to deliver a procurement exercise which covers a wide range of investment strategies including some of the newer global equity strategies that London Funds are developing an interest in such as sustainable equities. In total 9 investment strategies are being procured for the cost of 2 Fund searches. Whilst it is recognised that the decision on whether to invest in these individual strategies will of course be taken at a Local Fund level, they will be open to all 33 Pension Funds to invest. Managers selected under this procurement process will of course be subject to high levels of due diligence and ongoing monitoring.

Transition costs reduced

10. At this stage the only transitions to have taken place have revolved around moving existing mandates on to the CIV platform, with subscriptions into existing sub-funds only just starting to materialise.

11. The potential to undertake a London-wide procurement exercise for transition managers has been considered by the IAC, but capacity constraints at the CIV has meant that it has not been possible to take this forward at this stage, particularly given that the number of transitions was unlikely to be significant for some months. However, given that the global equity procurement and future investment procurement could mean that the numbers of transitions that occur are likely to increase over time; this is something that can be re-visited to see if transition manager savings can also be delivered.

12. The February 2015 paper also talked about the potential for a reduction of 'value leakage' as Funds move assets between managers outside the CIV platform and the

potential for internal CIV transitions to reduce this. Clearly at this stage it is too early in the life cycle of the CIV to assess the impact of this in terms of wider benefits.

<u>Manager Churn reduction</u>

13. This benefit can only be assessed over the longer term as the CIV appoints managers to the platform and performance is delivered.

<u>Custody Costs Reduced</u>

14. As the 2015 benefits paper referenced the potential for London Fund custody costs to decrease over time as assets move across on to the CIV platform. Whilst the CIV will continue to have custody costs as assets increase, the cost of these will decrease. For funds themselves, in time, they may no longer require a separate custodian for liquid assets thereby seeing an overall reduction in custody costs. Again, it is probably too early in the life cycle to calculate an accurate picture of the potential savings delivered, but the CIV will look to capture the current custody costs of London Funds to make an assessment of the savings delivered over time.

<u>Crossing (trades in pooled funds)</u>

15. Again this was highlighted as a potential cashable benefit for London Funds for crossing of trades within the London CIV Pool, as with a number of benefits, they can only be evidenced when the CIV is fully operational.

<u>Securities Lending</u>

16. This is not something that is currently undertaken by the CIV, but over the longer term will be considered once the CIV approaches a business as usual status.

<u>Foreign Exchange</u>

17. Looking at the cashable benefits savings from the February paper, there is scope for foreign exchange savings to be delivered, but again this is something for the longer term once a larger number of funds are operational.

Non-Cashable or 'Softer' Benefits

<u>Data Transparency and data access</u>

18. The ability of London Funds to view data across the different sub-funds and investment strategies will provide Funds with greater levels of transparency with individual managers. The London CIV is working on the best format to provide access to this data with a secure area of the website being key, which is one of the projects currently being considered as the CIV develops its reporting for London Funds.

<u>Shared investment manager oversight</u>

19. In addition to the London CIV undertaking its own in-depth scrutiny of the funds on its platform, London Funds themselves will have the opportunity to meet and discuss managers appointed to the CIV platform providing the prospect of greater scrutiny of both the underlying managers and the CIV itself.

Regulatory Scrutiny

20. With the London CIV being a regulated entity, London Funds can be assured that the oversight and scrutiny undertaken on the CIV will be significant and that all Pension Funds have to be treated fairly and that officers of the company have to be 'fit and proper' to perform FCA controlled functions. The fact that the London CIV was able to obtain FCA approval at a fund and operator level last autumn provides London Funds with the necessary assurances from a governance perspective when transferring assets to the CIV.

Governance / Shared Training / Shared Knowledge

21. The London CIV has conducted a number of seminars for the London Funds with more planned for the future. Whilst the majority of these have been targeted at officers within the Funds, further events are being planned which will also be open to the Pension Committee Members. This includes a Responsible Investment Seminar in January and an Investor Conference in March.

22. The Joint Committee has also received a number of presentations from the FCA, Treasury and on topics such as infrastructure.

Access to 'alternative' investment

23. The London CIV has in the early stages of development inevitably concentrated on the asset classes where London Funds have the greatest assets under management which has included passive and global equities. The development of a broader range of asset classes to include 'alternative' assets such as private equity and infrastructure will be developed over the coming years.

Responding proactively to the wider LGPS efficiency agenda

24. As Members know, the formation of the London CIV was at the forefront of efforts to improve the efficiency of London Pension Funds and in advance of the wider government pooling agenda. The CIV was able to collate data and provide a detailed response to the Government's Criteria and Guidance for both the February and July submissions to Central Government.

Market Management

25. As can be seen from the cashable fee savings and the global equity procurement process, the ability of the CIV to influence the fund management industry on fees is already evidenced. In terms of wider influences, as the CIV gains further traction, the ability to negotiate with managers to come up with bespoke products for London Funds could deliver wider benefits in the future.

More time at local level to focus on strategic issues

26. With London local authorities facing increasing pressure on local resources, the procurement of managers and the scrutiny of managers being undertaken by the CIV should enable Funds to concentrate on more strategic delivery of asset allocation and investment strategy.

Voting and Engagement

27. Having a standard approach to voting across London Funds and the ability over time to increase the level of engagement on a range of stewardship, environmental, social and governance with managers will help to ensure that London Funds have a stronger voice when engaging on these issues.

Reputation

28. As noted in the February 2015 paper, London Funds have led the way on delivering collaboration and have been at the forefront of pooling of investments. CIV officers have been sought out and have attended a number of pool meetings with other pools to provide assistance as they develop their own thinking on pooling, helping to enhance the reputation of London Funds.

Recommendations

29. The committee is recommended to:

    i. Note the contents of this report

Financial implications

30. There are no financial implications for London Councils

Legal implications

31. There are no legal implications for London Councils.

Equalities implications

32. There are no equalities implications for London Councils.