**Item 9**

# Pension Fund Investment Sub Committee

# 14 September 2015

# Passive Investment – Collaborative Working

## Recommendations

**(1) That the Pension Fund Investment sub-committee approve pursuing a collaborative procurement mandate for passively managed funds with other Authorities.**

**(2) That the Pension Fund Investment sub-committee delegate the negotiation and decision making on this procurement to the Head of Finance and the Strategic Director for Resources, in consultation with the Chair of this sub Committee.**

## 1 Introduction

1.1 In May 2013 the then Local Government Minister made clear in a speech that the structure of the LGPS was being considered, with Fund mergers a possibility for consideration. This speech was followed by a 'Call for Evidence' consultation that focused on the management of deficits and investment efficiency.

1.2 In May 2014, and following analysis of the responses received from the Call for Evidence, a further round of consultation was launched. This consultation ruled out forced Fund mergers in the near term and focused on the possibility of asset pooling (possibly via the formation of a small number of Common Investment Vehicles) and the increased use of passive management, both of which were thought to offer potentially significant savings in investment management fees across the LGPS.

1.3 The Summer Budget of July 2015 contained the following announcement:

"The government will work with the Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments."

## 2. Passive Investments held by the Fund

2.1 The consultation referred to in the Budget has not yet been issued, and there is no set date for when it will be issued. What is clear is that the Government will need to see significant efforts by the LGPS to reduce running costs (and especially investment management fees), or it will legislate to ensure that this happens.

2.2 The first logical step in reducing costs would be addressing the funds passively managed investments as this is the most liquid and simple area of the asset allocation in terms of a transition. Officers of the fund have been in discussion with six other Administering Authorities with a view to a joint procurement of passive investment management.

2.3 It is difficult to be specific about the likely fee savings in advance of the procurement, but informal discussions between other Authorities and some of the potential managers suggest that it will be very worthwhile. Passive management fees are already low in comparison to those charged by active managers, but it seems likely that a reduction of about 30-40% is achievable.

## 3. Collaboration

3.1 A meeting was held on 14th August with the group of Administering Authorities and the discussions were extremely encouraging. There was a clear common goal and willingness to proceed in a timely manner; in fact, the group was able to agree every point of importance. There was agreement of the need to appoint an investment consultant to carry out work in respect of the optimal outcome for the group, and four consultants have been approached to put forward submissions for how they would carry out this work. By the date of this Pension Fund Investment Sub Committee meeting the investment consultant will either have been selected by the group, or the appointment will be very close.

3.2 The outcome of the joint procurement will almost undoubtedly be that all of the Funds involved will have the same passive investment manager, as opposed to the three that are currently used (BlackRock, Legal and General and State Street). It is expected that the appointed manager will be able to provide pooled funds that replicate the indices that are already used by the individual funds, although there is a willingness on the part of the Funds to make slight revisions to their benchmarks (e.g. moving to the regional components of the MSCI[1] indices for overseas equities, rather than the FTSE equivalent) if this is beneficial.

[1] **Morgan Stanley Capital International** (**MSCI**) is an alternative stock market index to FTSE

## 4. The Process

4.1 It is hoped that the whole process, including restructuring any assets that will require transferring between investment managers, will be completed before the end of October 2015. This timetable is ambitious but it is believed that it can be achieved.

4.2 Officers will work with the fund investment consultant to ensure compliance with regulation, that the swing manager function (to ensure that the fund remains within its asset allocation as values increase/decrease with market fluctuation) can be maintained by the successful manager and that benchmarks are still appropriate.

## Background Papers

None

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