Nottinghamshire County Council

Report to Pension Fund Committee

7 June 2018

Agenda Item: 9

REPORT OF SERVICE DIRECTOR – FINANCE, PROCUREMENT & IMPROVEMENT

FUTURE OF THE IN-HOUSE EQUITY PORTFOLIO

Purpose of the Report

1. To discuss options for the future management of our current in-house equity portfolio.

Information

2. Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 requires administering authorities of LGPS Schemes to pool investments to reduce costs. LGPS Central Ltd was created by Nottinghamshire and other partners to deliver pooled investments to the member schemes. As funds become available, Nottinghamshire need to consider transferring investments to the pooled arrangements.

3. The in-house passive equity portfolio within Nottinghamshire Pension Fund amounts to around £1.5 billion. It consists of directly held shares in UK, Europe and North America, and some funds managed by Legal and General (LGIM).

4. LGPS Central is offering an internal passive equity fund to Pension Funds from May 2018. LGIM was procured by a number of partner funds to offer passive fund management before LGPS Central existed and is considered as part of the wider Pool. We need to consider the best option for Nottinghamshire Pension Fund.

5. Some information relating to this decision is not for publication by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972. Having regard to the circumstances, on balance the public interest in disclosing the information does not outweigh the reason for exemption because divulging the information would significantly damage the Council's commercial position in relation to the Pension Fund. The exempt information is set out in the exempt appendices.

Summary Assessment

Guiding principles

6. There are a number of issues we need to consider in deciding how to invest the in-house portfolio going forwards. These issues will to an extent be common to each of our major portfolios at the point at which we need to consider transferring to LGPS Central. These include:-

- Ongoing management costs
- Transition costs
- Quality and performance of the service
- Risk to service delivery
- Responsible Investment implications.

Ongoing Management Costs

7. Passive funds under any option are cheap to manage – transition costs are much more significant to the decision.

Transition costs

8. As far as possible we hope to transfer holdings rather than sell and repurchase to minimise transition costs. LGIM have a transitions team who would help with transitions into LGIM.

9. LGPS Central's Overseas passive fund has a different allocation to our current geographic allocation. If we change our allocation to enable us to invest in this fund, further rebalancing costs will be incurred. The rebalancing costs due to any Global allocation change could be significant.

Quality and performance

10. Quality considerations relate to differences in tracking error (how closely the index is followed), performance, reporting, and levels of service. We have experience of LGIM as we already have existing investments in their funds. LGPS Central is a new company and as such is still developing a track record.

Risk to Service Delivery

11. LGIM have massive scale in the market. Although there are some peripheral advantages to managing shares internally, there are challenges to smaller operators in accessing sufficient market liquidity, and lower economies of scale.

Market influence and Responsible Investment

12. Although the shares invested in (apart from the geographic split) would be largely the same with these options, the voting control would pass to LGIM, or to LGPS Central when we invest in their funds. Both LGIM and LGPS Central offer a good corporate engagement service. Although there are some minor differences between the two, and there is potential for a more bespoke service to be delivered through LGPS Central in the future, it is not considered that the differences are significant enough to influence the investment decision.

Related issues

13. We have a number of investments in funds within our in-house portfolio which are excessive compared to the index as they were purchased for specific reasons. Where we consider these are worth continuing to hold they will be transferred to the specialist portfolio.

14. The in-house portfolio will no longer be managed in house, so the name of the portfolio needs to be changed. It is sometimes also known as the Core Index portfolio, and this name will be used after transfer.

Responsibility for decision

15. It is the Pension Fund Committee's responsibility to appoint Fund Managers for portfolios and to set asset allocation. These key decisions need to be taken by the Pension Fund Committee. As this investment relates to a whole portfolio within the fund, this is a Pension Fund Committee decision. Members should note that future investments in particular subfunds through LGPS Central, within the agreed asset allocation will be the responsibility of officers.

Other Options Considered

16. Transferring all our investments to LGPS Central. This is not felt to be the best option due to the reasons summarised above and in the exempt appendix.

17. A combination of the two to enable comparison between the funds, and to enable our current global allocations to remain unaltered. This would enable us to keep our current geographical asset allocation if we wished, but would increase complexity, so is not recommended. However we are proposing a £10million investment in each LGPS Central fund to enable comparison between the two in the future.

Reason/s for Recommendation/s

18. The recommended actions propose the lowest cost and lowest risk option for the passive portfolio at the current point in time, and will reduce our rebalancing costs on transition, which are the most significant area of costs at this stage. Guiding principles will be set to assess future portfolio transfers.

Statutory and Policy Implications

19. This report has been compiled after consideration of implications in respect of crime and disorder, data protection and information governance, finance, human resources, human rights, the NHS Constitution (public health services), the public sector equality duty, safeguarding of children and adults at risk, service users, smarter working, sustainability and the environment and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

Financial Implications

There will be costs of transition and rebalancing. These will be managed to keep them as low as possible.

This transfer will help to realise the savings to be delivered as a result of Pooling.

RECOMMENDATION/S

1) The passive equity portfolio be transferred to LGIM except for £20 million which will be invested in LGPS Central (£10 million in the UK Fund and £10 million in the Global ex UK Fund).

2) The geographic split of overseas investments will be changed to the suggested LGIM allocation described in the exempt appendix.

3) Holdings within the current portfolio which are more specialist in nature will be transferred to the Specialist Portfolio.

4) The portfolio will be referred to as the Core Index portfolio after transfer.

5) The following guiding principles will be used in the assessment of the transfer of future portfolios:-

- Ongoing management costs
- Transition costs
- Quality and performance of the service
- Risk to service delivery
- Responsible Investment implications.

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For any enquiries about this report please contact: Tamsin Rabbitts

Constitutional Comments (SLB 30/05/2018)

20. Pension Fund Committee is the appropriate body to consider the content of this report.

Financial Comments (TMR 29/05/2018)

21. The financial implications are described within the report and the appendix.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

- None

Electoral Division(s) and Member(s) Affected

- All