

Scheme Advisory Board

Update briefing paper to the Procurement working group in relation to investment cost transparency

9 May 2018

1. Background

- 1.1. The Procurement working group assisted by the secretariat were asked by the Scheme Advisory Board to develop proposals for ensuring compliance with the Board's Code of Transparency by fund managers signed up to the Code. Further work may follow, depending on the outcome of and proposals by the FCA's Institutional Disclosure Working Group (IDWG), regarding the analysis of investment costs provided under the Code to enable greater understanding by the individual pension funds.
- 1.2. Investment cost transparency was an essential part of the government's investment reforms in 2016 and is a key element of the criteria for LGPS asset pooling.
- 1.3. This paper is intended to inform the thinking of the working group and to plan for the next two months leading to a request for a decision at the June Board meeting

2. Investment Cost Transparency

- 2.1. The Board views the move toward investment cost transparency and consistency as an important factor in the LGPS being perceived as a value-led and innovative pension scheme. Transparency is also a target for the revised CIPFA accounting and reporting guidance to be issued in respect of the statutory annual report and accounts.
- 2.2. To assist LGPS administering authorities in obtaining the more detailed investment fee data they require, the secretariat worked with a number of key stakeholders including investment managers, CIPFA and LGPS administering authorities to develop the Code of Transparency.

- 2.3. This Code, attached as Appendix A to this paper, was approved by the Board on the 6th March 2017 and launched on the 17th May 2017. To date, over 60 fund managers have signed up to the code covering in the region of £170 billion worth of the scheme's assets.
- 2.4. At present, compliance with the Code requires fund managers to complete and submit the Code template either quarterly or annually, without request, to their LGPS clients whether that be individual funds or pooled entities.
- 2.5. At present the Code template only covers listed assets. At its meeting on 26th February the Board agreed to adopt the template(s) to be agreed by the IDWG which will include unlisted asset classes either within a single template or via multiple templates .
- 2.6. For the purpose of this note, the secretariat is not aware of there being a material difference between the Board's template and that being established by the IDWG for listed assets. A copy of the Board's template is included here as Appendix B and can also be found at http://lgpsboard.org/images/CoT/LGPS_TemplateFINAL_March2017.pdf

3. Data collection exercise

- 3.1. At present, the template is in spreadsheet form and is submitted by managers directly to their LGPS clients, this requires:
- manual reminders of a requirement to complete for a particular pension fund client (pension funds may have different requirements on how often it is completed)
 - manual completion, checking and validation by the asset manager
 - manual checking of completion by LGPS fund officers of the submitted forms
 - manual submission the client LGPS pension funds and pools within the agreed timescale
- 3.2. While the template may be relevant and fit for purpose based on current reporting and regulatory requirements, both these underlying regulations and the methods of cost recovery and charging may change over time. Therefore the template(s) will need to be updated both to remain relevant with changes in regulation as well as the cost data to be checked. The

IDWG will be considering as part of its remit how the template(s) will be owned and evolved over time.

- 3.3. The Board asked the working group assisted by the Secretariat to develop proposals for a compliance and checking function with regard to completion and submission of the template – how this might be carried out, process managed and possible costs.
- 3.4. The IDWG is also considering how template data may be further analysed and used and in particular whether this could be achieved centrally. The outcome of this part of their remit will inform the Board with regard to the need to develop such functionality within the LGPS.
- 3.5. At this time therefore the scope of this work is focused on the ability to confirm compliance with the Code's requirement to complete and submit template data in line with agreed timescales and overriding regulatory requirements (in particular MiFID II).
- 3.6. The secretariat has spoken informally to third party companies who provide investment data collection and checking services and to LGPS fund managers about the current process. As a result of these discussions, it is considered that a slightly wider scope of work could be considered such that the template(s) can :
 - Be made more web-based enabling more efficient (and possibly automated) completion by fund managers
 - Be automatically checked for completion before submission (like many other on-line forms that flag where answers are not valid or not completed)
 - Be validated for compliance with regulation in force at the time of submission
 - Include automatic reminders to the fund manager for completion and automatic distribution to the relevant pension funds on the required timetable
- 3.7. There are some key requirements that various fund managers state are critical to also providing the template(s) to the Board or a third party for compliance and checking purposes – in particular that the data collected shall only be for the information of the underlying pension fund clients and

the Board. The fund managers signed up to the Code would not wish their data to be pooled by any third party for the purpose of the publication of manager level comparative data and 'league tables'

- 3.8. In this regard the independence of any third party would be crucial to the trust placed in the process.

4. Market sounding

- There are a number of ways for the compliance and checking function to be developed and implemented – whether in line with the original request from the Board or the slightly wider function as suggested above. The possible options are for the Board to purchase an 'off the shelf' solution to enable fund managers to submit their completed templates to the Board. The necessary resource would then need to be made available for a manual, in-house notification, checking and compliance function
 - to hire a consultant on a short term contract to develop a tailored on-line system. This system would have notification, checking and compliance functions built in and would provide reporting to the Board on an exception basis. The Board would own the IP but would need to ensure the hosting of the platform, security around the data and relevance of the template for changing standards was managed timely and appropriately.
 - to procure the services of a third-party data analytics firm to design, host and code a tailored compliance and checking system. That firm would then be responsible for all the security issues around a web-based platform, the Board would be the client but the third-party firm would have no rights to use the data other than for what is set out in the agreed contract.
- 4.1. The Secretariat has had very informal and early discussions with possible third-party providers and believe there is both capability and appetite for such a contract. However, this needs further investigation.
- 4.2. In order for the Board to have all the relevant information it needs for the meeting on the 27th June, the secretariat intends to use the intervening period for an informal market sounding on each of the possible options above and will report back to the procurement working group. If the working group agrees, the secretariat will, over the next month:

- investigate the capability and capacity necessary for an in-house solution,
 - research possible external consultants that could provide the necessary development service for a tailored solution, and
 - speak to some third-party providers who we believe can meet the requirements, in particular their independence from the asset management and benchmarking industries and their ability to hold the data securely
- 4.3. To facilitate this research, it is proposed to use the briefing note at Appendix C [to be written] to ensure that any discussions with third parties can be focused on the necessary requirements and that meaningful answers are given to specific questions. This will include indicative costs which would then give an indication of a procurement route – I.e. whether a full EU tender process is required.
- 4.4. Following this information gathering, the secretariat will present the results and analysis to the procurement working group and subsequently to the Investment, Governance and Engagement committee in May and the Board in June. The Board will be able to make an informed decision on the scope of the envisaged role, solution to fulfilling that scope, relevant procurement route and indicative timetable.

Recommendation – that the procurement working group notes the proposals set out above and agrees to present this to the Investment, Governance and Engagement committee for consideration on the 30th May 2018.

Appendix A – Transparency Code

LGPS Investment Code of Transparency (“the Code”)

Date of Publication: 18th May 2017

Definitions

For the purpose of this Code the following definitions shall apply:

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| Administering Authority | means the administering authority of a pension fund within the LGPS. For the purposes of the Code only this term shall also apply to the operator of any LGPS investment pool |
| Board | means the Local Government Pension Scheme Advisory Board |
| Investment Manager | means an investment manager, who has been or wishes to be, appointed by an Administering Authority in accordance with the Investment Regulations |
| Investment Regulations | means The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (as from time to time amended or replaced) |
| LGPS | means the Local Government Pension Scheme for England and Wales |
| Template | means the template information form for the relevant investment types provided by the Board as updated from time to time and made available on the Board’s website |

A Introduction

1. The Board is a body established under the Local Government Pension Scheme Regulations 2013. The function of the Board is to provide advice to the Secretary of State on the desirability of making changes to the LGPS. The Board also has the function of providing advice to Administering Authorities and local pension boards in relation to the effective and efficient administration and management of the LGPS and their pension funds. The Board has the power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.
2. The Board views the move toward investment cost transparency and consistency as an important factor in the LGPS being perceived as a value-led and innovative pension scheme. Transparency is also a target for the revised CIPFA accounting standard issued for inclusion in the statutory annual report and accounts and is included in the government’s investment reform guidance and criteria for LGPS pooling.
3. To assist LGPS administering authorities in obtaining the more detailed investment fee data they require, the Board has worked with key stakeholders including investment managers, CIPFA and LGPS administering authorities to develop the Code.
4. The Administering Authority and the Board recognise their obligations pursuant to the Freedom of Information Act and the Section 45 FoIA Code of Practice and will engage with Investment Managers appropriately in that respect.

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B Application of the Code

5. The Code is a voluntary code and covers the provision of transparent and consistent investment cost and fee information between Investment Managers and Administering Authorities.
6. An Investment Manager may sign up to the Code in writing in the form agreed by the Board. By doing so the Investment Manager is demonstrating its commitment to the transparent reporting of LGPS investment costs and fees to administering authorities.
7. An Investment Manager who signs up to the Code in respect of the investment types covered by the Code agrees that within a period of twelve months of signing up to the Code (or such longer period as the Board may in its discretion agree) it will put in place the systems necessary to allow the completion and automatic (i.e. without the client having to make a request) submission of the Template(s) to each Administering Authority that the Investment Manager is appointed by (whether at the time of signing up to the Code or in the future).
8. 7A. Where an asset class is not covered by the template(s) available under the Code, an investment manager may sign up on the understanding that within a period of 12 months (or such longer period as the Board may in its discretion agree) it will put in place the systems necessary to allow the completion and automatic (i.e. without the client having to make a request) submission of cost data substantially similar in scope and detail to that covered by existing templates. The exact format of that cost data is to be agreed with each Administering Authority that the Investment Manager is appointed by (whether at the time of signing up to the Code or in the future). Managers who sign up to the Code under this provision must adopt and make use of relevant Code templates as they become available.
9. Where an asset class is not covered by the template(s) available under the Code, an investment manager may sign up on the understanding that within a period of 12 months (or such longer period as the Board may in its discretion agree) it will put in place the systems necessary to allow the completion and automatic (i.e. without the client having to make a request) submission of cost data substantially similar in scope and detail to that covered by existing templates. The exact format of that cost data is to be agreed with each Administering Authority that the Investment Manager is appointed by (whether at the time of signing up to the Code or in the future). Managers who sign up to the Code under this provision must adopt and make use of relevant Code templates as they become available.
10. The Template(s) must be submitted automatically (i.e. without the client having to make a request) each year to each Administering Authority (if required by the Administering Authority) and to any independent third party appointed by the Board in accordance with paragraph 12. Administering Authorities may also request such submissions on a quarterly basis.
11. There are separate Templates for segregated portfolio management and for pooled funds. Where an Investment Manager operating a segregated mandate invests in a pooled fund as part of that mandate, the reporting will be done via the Investment Manager's own Template.
12. The Investment Manager will not vary the Templates except with the written agreement of the Board and the relevant Administering Authority.
13. The current Templates only apply in relation to listed asset classes. Templates for unlisted asset classes such as private equity will be developed in due course. It is envisaged that the Templates will develop over time to encompass other more challenging areas of cost transparency and will remain flexible to enable changes to meet the rapidly developing market for investment products. The listed asset Template may be amended from time to

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time to keep in line with the Investment Association's Disclosure Code and/or the outcome of the FCA's Institutional Disclosure Working Group, IDWG.

14. The Board may appoint an independent third party to audit Templates provided in accordance with the Code and general compliance of the Code by Investment Managers. The third party may also be asked by the Board to collate, analyse and publish generic, non-attributable information obtained from the Templates at a national level. The Investment Manager shall co-operate with the Board and/or appointed third party and provide such information and explanations as the third party may reasonably require within a reasonable period of request.
15. The third party shall report the findings of any audit direct to the Board, including any recommended actions or improvements. The Investment Manager shall co-operate and work with the Board to address and implement any recommended actions or improvements.
16. The Investment Manager may, subject to any overarching legal or reporting requirements, require an Administering Authority to sign up to a reasonable confidentiality agreement not to disclose the information contained in the Template to any third parties (excluding any third party appointed by the Board).
17. The Board agrees that when an Investment Manager signs up to the Code in the agreed form it will, as soon as reasonably practicable, list the Investment Manager on its website and allow the Investment Manager to use the Code's logo on its marketing literature in accordance with the Code Logo Use and Guidance (available from the Board website and amended from time to time). The Code Logo Use and Guidance can be downloaded from the Board website.
18. The Board owns the Code logo and will retain all intellectual property rights and any other rights in the Code logo. An Investment Manager will not acquire any rights, title or interest in the Code logo and will not use the Code logo except as expressly specified in the Code and the Code Logo Use and Guidelines.
19. An Investment Manager will be permitted to use the Code logo on a non-exclusive basis to communicate their compliance with the Code. The Code logo will convey to stakeholders that the Investment Manager is compliant with the Code and committed to the transparent reporting of LGPS investment costs and fees.
20. An Investment Manager will not use the Code logo for any other purpose nor for the benefit of any other person and will not alter or change the Code logo in any way – ownership of any modifications in the Code logo will vest in the Board.
21. The Board may revoke use of the Code logo and remove an Investment Manager from the list on its website at any time if an Investment Manager is reported by an Administering Authority to be in breach of the Code.

Appendix B – Transparency Template

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Appendix C – Briefing note on scope and specification of the requirement for informal market discussions

Market sounding: We propose to discuss with these various parties the following specific questions. This will include indicative costs for the service which would then give an indication of a procurement route, including whether a full EU tender process is required or only part of it.

This informal market sounding will be on a no obligation, non-binding, non-contractual basis and purely to provide more detailed information for the procurement working group to recommend a course of action to the Scheme Advisory Board.

The parties that will be involved in this informal market sounding will have explained to them the background to the request together with the current template.

- 1.1. What is the business model of the supplier? i.e. are they a performance monitoring provider like a) CEM benchmarking or PIRC b) an ALM provider like ORTEC or c) a FINTEC company like E-Vestments or Simplitium.
- 1.2. What is the structure of the team, the individuals the firm would use and the track record of those individuals either at their firm or their previous firm?
- 1.3. What type of platform could be proposed i.e. single or multi party? However information will need to be confidential as this is a requirement to which the Investment managers have signed up to.
- 1.4. Who would they envisage as the owners of the information?
- 1.5. Would the supplier want to a) build and manage a bespoke system b) build a bespoke system but hand over to us for day to day management (how would the relationship work?) c) provide an “off the shelf” package or d) any other offering?
- 1.6. What could the associated costs be (up front and ongoing) with regards to the above?
- 1.7. With regards to 1.5 how would they view the term of the contract i.e. a) a one off or b) Multi year? If so for how long?
- 1.8. If a multi-year contract – How would they look to structure the contract?

- 1.9. How will the supplier work with us with regards to designing the system, working with the Investment Managers/LGPS Funds, fetch functions and reporting?
- 1.10. What could the timeline for delivery be?
- 1.11. Provide the templates to the suppliers with NDA's in place so they can spec out our requirements?
- 1.12. What is the state of play with regards to Freedom of Information?