Pensions Committee

2.30p.m, Tuesday, 23 September 2014

Pension Fund Investment Staffing

Item number	5.5
Report number	
Executive/routine	
Wards	All

Executive summary

The risk of the lack of remuneration benchmarking and short notice periods for investment staff has been highlighted by an external consultant's inspection of the pension fund operations. This report highlights the issue and potential options to manage the risk.

The options involve different risks and implications for the investment strategy and budget for the pension funds.

Pensions Committee is asked to agree to employ pension fund investment staff via a special purpose vehicle separate to the Council. As a phase 1 pilot, 6 posts of grade 10 or above (11 staff members) would be transferred. Consultation with staff would then progress and requisite approval for the establishment of the special purpose vehicle would then be sought.

Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	

Report

Pension Fund Staffing

Recommendations

1.1 Pensions Committee is asked to agree to employ certain pension fund investment staff via a special purpose vehicle separate to the Council, consult with staff and request requisite approval for the establishment of the special purpose vehicle.

Background

2.1 Lothian Pension Fund has, for many years, in-sourced investment management for part of the Fund. Aside from lower cost, the advantages of internal investment management include the fact that investment staff are more clearly aligned to the pension fund, they are not distracted by non-investment issues (such as marketing, advertising, client service and business development). Independent analysis of local government pension fund schemes shows that funds which are internally managed outperform in the long term.

2.2 Over recent years, the internal team has been expanded, which has facilitated further in-sourcing investment functions as well as the development of innovative and low cost investment strategies to meet the significant funding challenges faced by the pension funds.

2.3 The team currently manages over £3bn (63% of the pension funds). The costs of managing the pension funds are deducted from the funds. The budget for 2014/15 is £13.6million, which includes £9.5million for external investment management costs.

Main report

3.1 The Director of Corporate Governance requested a review of investment governance arrangements of the pension funds and in December 2013, an external consultant was appointed to review the investment operations particularly relating to the internally managed investments. The review considered governance and organisational structure, team size and adequacy, compliance processes and controls and investment systems by comparison to industry best practice in the private sector, but also in the context of the structure of a local government pension fund.

3.2 The review concluded that the existing systems and controls are generally sufficient for the Fund's current investment activity. However, the consultant highlighted a key risk associated with staff remuneration and retention which had also been identified as a risk internally as follows:

Staff remuneration and retention: the review identified that the Fund does not externally benchmark salaries and that the notice period provisions in staff contracts were not in line with market practice for the relevant roles. The consultant also noted that the Fund adheres to wider Council Human Resource (HR) policies and procedures but ideally special arrangements should be made for key staff to mitigate this risk.

3.3 It is well recognised in the investment industry that stability of employees with a well defined objective is a key indicator of success and turnover of staff is a recipe for poor outcomes. Not only could significant change prompt an expensive contingency plan, it could jeopardise the strategy.

3.4 Since the consultant reported their findings, analysis has been undertaken on the impact of loss of investment staff and advice sought from the Council's Organisation Development regarding remuneration benchmarking and staff retention.

3.5 A contingency plan is also being put in place to ensure that, if the risk materialised, the operational risks could be closed quickly. Indicative costs of such a contingency are significant with additional fees of £8-10million per annum plus one-off transaction costs. These are central scenario estimates. In addition workforce and succession planning strategies are being reassessed to help mitigate the risk of people potentially leaving the service in future.

3.6 Insight into the investment management industry indicates that the risk of staff departures is considered to be meaningful. As outlined above, the potential implications for the pension funds are significant.

3.7 Pension fund staff are Council employees and are subject to the Local Government terms and conditions of service negotiated and implemented in October 2010 in response to the Single Status agenda. Hence changes to the terms and conditions are not straightforward.

3.8 Options to manage/mitigate this risk are as follows:

- Option 1: Tolerate the risk and enact the contingency plan in the event of the risk materialising. Prompt and immediate action would be required to implement the contingency and reduce operational risks. However, some risks will inevitably remain.
- Option 2: Introduce different terms and conditions for affected staff. While this would help to manage the risk to the pension fund, it could increase the risk that the Council is exposed to further equal pay claims.
- Option 3: Close down the risk and out-source the investment management service. This would have major strategic and financial implications for the

pension fund, similar to those resulting from enactment of the contingency plan.

- Option 4: Employ staff via a special purpose vehicle separate to the Council.

3.9 The options involve different risks and implications for the investment strategy and budget for the pension funds. The preferred option is Option 4. Not only would this enable the current investment and funding strategies to be implemented to achieve the pension funds' objectives, it would allow for opportunities to further develop strategies and reduce costs. Staff will simply move into a special purpose vehicle and there would be no changes to the fund.

3.10 The special purpose vehicle would be wholly owned by the Council and there should be a formal and transparent procedure for developing policy on remuneration. .

3.11 It is proposed that the board of the special purpose vehicle consist of the Director of Corporate Governance, Head of Finance and Head of Organisation Development and Investment & Pensions Service Manager. They would be responsible for the setting of remuneration and terms and conditions of employment. However, the Investment & Pensions Service Manager would not be involved in any decision as to their own remuneration or terms and conditions.

3.12 This does not necessarily imply that salaries will be higher in the special purpose vehicle. The arrangement will allow the Board to consider benchmarking information and decide on appropriate terms and conditions in the future.

3.13 As a phase 1 pilot, 6 posts of grade 10 or above (11 staff members) would be transferred. The posts are the Investment & Pensions Service Manager, Investment Manager, Pensions & Accounting Manager, Legal & Risk Manager, Financial Controller and Portfolio Manager. They are all directly involved in the internal investment management function. Additional consideration could be given to the transfer of other roles and this would be the subject to consultation with trades unions and staff.

3.14 Pensions Committee is asked to agree to employ pension fund investment staff via a special purpose vehicle separate to the Council.

3.15 The next steps would be that requisite approval for the special purpose vehicle would be sought and consultation with staff and trades unions would be undertaken.

Measures of success

4.1 The investments of the pension funds are measured using performance indicators relative to market benchmarks.

Financial impact

5.1 The investments of the pension funds are critical in determining the contribution rates payable by the City of Edinburgh Council and other employers in the pension funds.

Risk, policy, compliance and governance impact

6.1 The risk of the lack of remuneration benchmarking and short notice periods for investment staff has been highlighted by an external consultant's inspection of the pension fund operations. This report highlights the issue and potential options to manage the risk.

6.2 The transfer of certain staff to a special purpose vehicle could impact on staff morale, both for those directly affected and others in the Fund not transferring to the special purpose vehicle. This risk will need to be managed accordingly. Communication will be particularly important in the lead up to the transfer.

Equalities impact

7.1 There is no equalities impact as a result of this report. Options to address the risks highlighted in this report could have an impact on equalities. Full equalities impact assessment would need to be undertaken as options are explored further.

Sustainability impact

8.1 Sustainable investing of pension fund monies is heavily reliant on a stable team. This report highlights the risk of loss of personnel and consequences, as potential options to mitigate this risk.

Consultation and engagement

9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds. They attend meetings of the Pensions Committee.

9.2 Consultation and engagement with associated staff will be important as the options for change are developed.

Background reading / external references

None.

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Links

Coalition pledges	
Council outcomes	CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.
Single Outcome Agreement	
Appendices	