

Pensions Committee

2.00pm, Wednesday, 26 September 2018

Appointments of Providers

Item number	5.7
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

This report provides an update on the appointment of providers for services to the pension funds.

It provides details of the procurement process for an 'Independent Professional Observer Service for Lothian Pension Fund' and recommends that the Pensions Committee note the award of the contract for the delivery of this service.

In addition, it seeks approval to award a contract for the delivery of an 'Investment Front Office Software System' (subject to agreement regarding mutually acceptable terms and conditions) and the Actuarial Services.

The report also updates the Committee on the procurement of Stewardship Services for the fund and the extension to the current contract.

Appointment of Providers

1. Recommendations

Committee is requested to:

- 1.1 Note the contract for an Independent Professional Observer for the Lothian Pension Fund that was awarded to Andy McKinnell Limited;
- 1.2 Approve the contract for the delivery of an 'Investment Front Office Software System' to Charles River Development (subject to agreement regarding mutually acceptable terms and conditions); together with requisite approval of the both the additional capital budget in 2018/19 of £43,000 and future years' additional annual revenue budget of £346,000, with £80,000 being in respect of 2018/19, as detailed at paragraph 5.2;
- 1.3 Approve the contract for Actuarial Services for the Lothian Pension Fund to Hymans Robertson LLP; and
- 1.4 Note the delay in the procurement process for Stewardship services and that, in the interim, the current contract has been extended to 30 June 2019.

2. Background

- 2.1 Service providers to the pension fund are reviewed, and tendered, on a regular basis. The way in which services are procured, and the process and resource involved in the process, depends on the expected costs of the service. The more significant contracts are typically procured via advertising in the Official Journal of the European Union (OJEU), with a number of officers involved in assessing potential providers. Each provider is required to evidence their ability to provide the service, for example by providing references and via interviews.
- 2.2 Collective procurement by the Local Government Pension Scheme (LGPS) has increased over recent years, particularly using the National LGPS Framework which is coordinated by Norfolk County Council. Frameworks are available for all LGPS funds to use, enabling the LGPS to optimise combined buying power to deliver greater value for money and offering all funds fast and efficient access to services via a fully OJEU compliant route.
- 2.3 At its meeting in September 2017, the Pension Committee agreed that the Fund deviate from the Council's standard procurement process in order to act in the best interests of its member and employers, and in accordance with its statutory fiduciary duty, provided always that both Community Benefits and Fair Working

Practice considerations are borne in mind at the outset of any procurement process to the extent that they would not have an adverse impact on the Fund's stakeholders.

- 2.4 This report and its appendices provide an update on recently completed procurements and ongoing procurements.

3. Main report

Independent Professional Observer (IPO)

- 3.1 In order to ensure the continuing robust strength of governance of the Scheme, the Fund has an Independent Professional Observer (IPO) Service which will provide guidance to the Pensions Committee in the exercise of its duties.
- 3.2 The previous contract for delivery of the service, which commenced in March 2013, was held by SmartCats Consulting and expired on 28 February 2018. In the interim, the service has not been available to Committee.
- 3.3 In June 2018, an open procurement competition was undertaken to source an appropriate Independent Professional Observer for the Lothian Pension Fund. Details of the procurement process set out in Appendix 1 of this paper.
- 3.4 The appointment of the IPO, Andy McKinnell, was subsequently approved by the Executive Director of Resources and Convenor of the Pensions Committee to enable the IPO to be in place before the meeting of the Pensions Committee in September.
- 3.5 The term of the new contract will be from September 2018 for an initial period of 3 years, with options to extend for up to 2 further periods of 2 years each, giving a total potential contract period of 7 years. The total value of the proposed contract, including extensions, is estimated at £154,000.

Investment Front Office Software System for Lothian Pension Fund (IFOSS)

- 3.6 Internal investment management of the Fund's assets involves a number of manual processes which have become increasingly complex.

Hence the Fund has sought an Investment Front Office Software System (IFOSS) to ensure that its investment function continues to be efficiently managed and to be in-line with best-practice as regarded by FCA. Further, it is anticipated that the system will facilitate the provision of investment management services to collaborative partners at some point in the future.

The term of the proposed new contract to provide the system will be from September 2018 for an initial period of 4 years, with options to extend for up to 3 further periods of 1 year each, giving a total potential contract period of 7 years.

Based upon the Fund's current requirements, the anticipated cost of the contract for the initial 4-year period is £1,827,322. This includes estimated one-off implementation costs of £242,886 in the first year, together with annual price increases by the rate of US inflation + 3% in years 2, 3 and 4.

This equates to an estimated average annual cost over the initial 4-year period of £456,830.

The total value of the proposed contract, including extensions, is currently estimated at £3,259,369.

- 3.7 An open procurement competition was undertaken to source an appropriate supplier. The Invitation to Tender was published on Public Contracts Scotland.
- 3.8 Details of the procurement process is provided in Appendix 2 of this paper. It is recommended that Committee approve Charles River Development (subject to agreement regarding mutually acceptable terms and conditions) to deliver the service.

Lothian Pension Fund Actuarial Services

- 3.9 Lothian Pension Fund has a statutory requirement for the provision of external actuarial certification services on a triennial basis.
- 3.10 As well as actuarial valuations, the fund needs an actuarial service to:
- Provide updates on the funding position since the last full actuarial valuation; and
 - Monitor and respond to changes in circumstances, e.g. reviewing scheme documents such as the investment strategy, funding strategy or recovery plan.
- 3.11 Appendix 3 of this report covers the procurement of the Actuarial Services for the Lothian Pension Fund.

Lothian Pension Fund Stewardship Services

- 3.12 In order to ensure the continuing robust strength of governance of the Scheme, Lothian Pension Fund requires an effective Stewardship Service which will support the integration of stewardship best practice into the investment processes and decision-making and support the Fund with internal and external communication with regards to voting, stewardship and engagement policies.
- 3.13 The current contract for delivery of the service is held by Hermes Equity Ownership Services.
- 3.14 It was anticipated that the Fund would work with its collaborative partners to undertake a joint procurement exercise to appoint a common voting and engagement partner. However, the review of investment strategy has taken priority for the collaborative efforts and the consideration of voting and engagement strategy has been delayed. Committee is asked to note the delay in the procurement process for the Fund's Stewardship and that, in the interim, the current contract has been extended to 30 June 2019.

4. Measures of success

- 4.1 Providers are set objectives against which performance is assessed. Regular tendering of providers ensures services are reviewed.

5. Financial impact

- 5.1 Appropriate provision for costs for the IPO and Actuarial Services have been provided within the Fund's approved budget.
- 5.2 Costs for the IFOSS are significantly higher than those included in the Fund's budget. This is summarised below:

Investment Front-Office Software System	Approved Budget	Anticipated Contract Value	Additional Budgetary Requirement
	£'000	£'000	£'000
Capital expenditure: set-up and implementation	200	243	43
Revenue Expenditure (please see note below)	50	396 (annual sum, based on initial term of 4 years)	346 For 2018/19, the required sum will be reduced to, owing to estimated implementation in early 2019. This is estimated at £80K.

Note: Collaborative partnership on investment management services would serve to reduce the net cost to Lothian Pension Fund. This would require permission by the Financial Conduct Authority and is the subject of a separate report to this Committee.

- 5.3 The costs associated with procuring the Independent Professional Observer contract are estimated at up to £10K.
- 5.4 The costs associated with procuring the Investment Front Office Software System contract are estimated at between £20K-£35K.
- 5.5 The costs associated with procuring the Actuarial Services contract are estimated between £10K-£20K.

6. Risk, policy, compliance and governance impact

- 6.1 Management of service providers and appropriate procurement reduces risk to the pension funds.

- 6.2 The Independent Observer role supports and strengthens the Fund's governance arrangements.
- 6.3 Financial Probity Evaluation was conducted by Finance colleagues and confirmed that Charles River Development comfortably meets the minimum criteria stipulated in the Invitation to Tender documents and are therefore considered financially sound. The tender bid received from Charles River Development, together with their presentation / demonstration, also provided sufficient information to suggest that they have extensive experience together with the necessary technical ability to deliver the requirement effectively whilst ensure full compliance with all FCA and DPA requirements.

7. Equalities impact

- 7.1 There are no equalities implications as a result of this report.
- 7.2 In reference to the IFOSS procurement, Charles River Development have given assurances that they do not intend to employ workers (included any agency or sub-contractor workers) on zero hours contracts. Additionally, they have given assurances that they intend to pay all workers the Living Wage.

8. Sustainability impact

- 8.1 None.

9. Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.
- 9.2 Members of the Pension Board and Pensions Committee were involved in the interviews for the Independent Professional Observer.

10. Background reading/external references

- 10.1 None.

Stephen S. Moir

Executive Director of Resources

Contact: Bruce Miller, Chief Investment Officer, Lothian Pension Fund

E-mail: bruce.miller@edinburgh.gov.uk | Tel: 0131 469 3866

Contact: Erin Savage, Pensions Operations & Development Manager, Lothian Pension Fund

E-mail: erin.savage@edinburgh.gov.uk | Tel: 0131 529 4660

Contact: Struan Fairbairn, Chief Risk Officer, Lothian Pension Fund

E-mail: struan.fairbairn@edinburgh.gov.uk | Tel: 0131 529 4689

11. Appendices

Appendix 1 – IPOS appointment

Appendix 2 – Investment Front Office Software Systems (IFOSS) appointment

Appendix 3 – Actuary appointment

Independent Professional Observer

Summary of Tendering and Tender Evaluation Processes

The Independent Professional Observer is a relatively specialised and supply market analysis suggested limited numbers of appropriately qualified and experienced potential suppliers active in the market.

An open procurement competition was undertaken to source an appropriate supplier. The Invitation to Tender was published on Public Contracts Scotland, giving potential bidders 21 days in which to prepare and submit their tender bids.

A total of 6 organisations submitted tender bids. One of these organisations submitted 2 candidates, giving an overall total of 7 tender proposals which were evaluated.

In view of the nature of the service, the Fund set a fixed contract price of £22,000 per annum for the initial 3 years of the proposed contract. This is based upon the previous contract price and includes a modest inflationary increase. Technical evaluation of the bids was conducted on the 'Most Economically Advantageous Tender' (MEAT) basis, with 100% of the overall evaluation score given to quality at the agreed price. To further ensure the quality of the recommended tender bid, Tenderers were advised that the Fund may disqualify any Tenderer who scored 0 or 1 (Poor or Unsatisfactory) in any scored question.

Initial evaluation of all formal written tender bids received (Stage 2A) was undertaken in order to identify the best tenders and to filter out any bids with conflicts of interest. The 3 top scoring Tenderers were then invited to Stage 2B where they were required to deliver a presentation in order to demonstrate their knowledge and understanding of the requirement.

The following table gives a summary of the scores awarded to each of the bids received:

Organisation	Stage 2A Weighted Quality Score (maximum 100%)	Stage 2B Weighted Quality Score (maximum 100%)
Andy McKinnell Limited	80.0	87.5
Tenderer 2	75.0	75.0
Tenderer 3	70.0	62.5
Tenderer 4 *	75.0	n/a
Tenderer 5 *	55.0	n/a
Tenderer 6 **	55.0	n/a
Tenderer 7 **	35.0	n/a

* A potential conflict of interest was identified with these Tenderers and as a result they were not invited to Stage 2B (the Tenderer Presentation event).

** These Tenderers responses achieved scores of 0 or 1 mark in respect of 1 or more questions and so were not invited to Stage 2B (the Tenderer Presentation event).

Contract	Independent Professional Observer Service for Lothian Pension Fund	
Contract period (including any extensions)	September 2018 to September 2025 (including up to 2 extension periods of 2 years each – a total of up to 7 years).	
Estimated contract value	£154,000 (including possible extensions).	
Procurement route chosen	Open Tendering procedure	
Tenders returned	7	
Recommended supplier	Andy McKinnell Limited	
Price / Quality Split	Quality: 100% (price is fixed at £22,000 p.a. for initial 3 year period of the contract).	
Evaluation criteria and weightings and reasons for this approach	Criteria - Stage 2A (Written Tender Submission)	Weighting
	Curriculum Vitae	60%
	Local Government Pension Scheme (Businesses And Individuals) - knowledge	20%
	Pensions Committee Reports – Comments And Questions	20%
	Conflicts of Interest	n/a
	Additional Information	n/a
	Criteria - Stage 2B (Tenderer Demonstration)	
	Local Government Pension Scheme (Businesses and Individuals) – knowledge demonstrated.	50%
	Pensions Committee Reports – Comments and Questions – knowledge demonstrated.	50%
	The quality of the service delivery was recognised as being more important than the cost because of the nature of the service itself.	
Evaluation Team	Stage 2A: Council Officers (x3) from LPF. Stage 2B: Pension Committee members (x2) and Pension Board members (x2)	

Investment Front Office Software System for Lothian Pension Fund (IFOSS) - Summary of Tendering and Tender Evaluation Processes

The IFOSS is a specialised requirement and as such is not currently available via existing frameworks. However, supply market analysis suggested that a relatively vibrant and well-established marketplace exists, with several potential specialist suppliers already active.

An open procurement competition was undertaken to source an appropriate supplier. The Invitation to Tender was published on Public Contracts Scotland, giving potential bidders 30 days in which to prepare and submit their tender bids.

A total of 3 organisations submitted tender bids. Technical evaluation of the bids was conducted on the ‘Most Economically Advantageous Tender’ (MEAT) basis, with 70% of the overall evaluation score given to quality and 30% to price. To further ensure the quality of the recommended tender bid, a minimum acceptable quality threshold of 60% was applied. In addition, Tenderers were advised that the Fund may disqualify any tender which scored 0 or 1 (Poor or Unsatisfactory) in any scored question.

The possible expansion of the Fund’s operations which may result from this, tenderers were also required to provide alternative pricing based upon a notional higher number of licence users etc.

Initial evaluation of all tenders received was undertaken by a panel comprised of 3 officers from the Fund. Following this, tenderers were required to deliver a presentation to demonstrate the technical proficiency of their proposed systems and satisfy the evaluation panel (comprised of 4 officers from the Fund) as to their suitability.

The following table gives a summary of the scores awarded to each of the bids received:

Organisation	Quality Weighted Score (maximum 70%)	Price Weighted Score (maximum 30%)	Total Weighted Score (maximum 100%)
Charles River Development	64.068	27.48	91.548
Tenderer 2	57.987	26.01	83.997
Tenderer 3	52.229	30.00	82.229

Contract	Investment Front Office Software System for Lothian Pension Fund	
Contract period (including any extensions)	September 2018 to September 2025 (including up to 3 extension periods of 1 year each – a total of up to 7 years).	
Estimated contract value	£3,259,369 (based upon current requirement, including possible extensions).	
Procurement route chosen	Open Tendering procedure	
Tenders returned	3	
Recommended supplier	Charles River Development	
Price / Quality Split	Quality: 70% Price: 30%	
Evaluation criteria and weightings and reasons for this approach	Criteria - Written Tender Submission Topics	Weighting
	1. Understanding of the Requirement.	10%
	2. Organisation – capability, capacity, future development / investment.	15%
	3. Technical system functionality.	50%
	4. Implementation, resourcing and ongoing support.	20%
	5. Hosting / software requirements.	2%
	6. Human Resources – policies and strategy.	3%
	7. Zero hours contracts & the living wage.	n/a
	Criteria - Tenderer Demonstration / Presentation Topics	
	1. Demonstrate simple trades in equities, Sovereign bonds (UK, German, Mexican), and corporate Bonds (Investment Grade and High Yield).	10%
	2. Demonstrate how a simple trade could be generated from and fairly allocated over three portfolios of differing sizes with differing underlying weights.	10%
	3. Demonstrate an equity basket trade, simulating a transfer from a global portfolio with a large Asian weighting to a large US weighting. Demonstrate this in two ways – direct upload of trades, and upload of target portfolio with the system calculating the required changes. At least 20% of names in the portfolio should be traded, including rebalances and outright buys/sells.	24.3%
	4. Using S&P500 minis, show how a contingently traded futures overlay could be entered alongside the above basket trade to ensure continuous market exposure.	5.5%

	5. Demonstrate an FX trade. The trade should use the data from the above basket trade and show how to use the system to calculate and neutralise changes in FX exposure.	10%
	6. Demonstrate back office functionality for clearing and settlement, specifically showing what part of the process would be entirely automated and where manual input is required. This should be done for Equities, Bonds and FX.	8.6%
	7. Demonstrate how to set three different trading limits: individual manager limit of £25m for a single trade (with larger trades needing compliance sign off by the CIO or CEO); a limit of 10% in a single stock in a single portfolio; a limit of 2% of issued shares for a company being owned by LPF across all portfolios. Show how these warnings would manifest in a trading environment. Demonstrate how 4-eyes sign off functionality works in practice.	11.4%
	8. Demonstrate, using the S&P minis example above, how your system would calculate margin requirements, and whether margin calls could be fed directly through the system or would have to be managed manually.	2.9%
	9. Demonstrate how your system will help LPF manage collateral requirements for swap contracts under upcoming EMIR regulations.	2.9%
	10. Demonstrate how the system would auto-generate required MIFID 2 reporting.	2.9%
	11. Demonstrate how the system can build in FCA and other routine compliance controls/blocks, for instance around: (i) a client's categorisation changing, (ii) insufficient KYC and AML, (iii) fraud and market misconduct/personal dealing, (iv) insider dealing, watch and restrict lists etc. Show how the system builds in capability for involvement, awareness and checks between the Front Office, Back Office and the Risk and Compliance Teams.	4.3%
	12. Demonstrate how the system can support LPFI in ensuring and evidencing that trade aggregation and allocation does not unfairly disadvantage its clients (e.g. where the orders of more than one client or the client and the firm's proprietary orders form part of an aggregated order) and that subsequent allocations to individual accounts are done fairly and with appropriate levels of segregation.	2.9%
	13. Demonstrate how the system enables LPFI to record and retain information in relation to orders and executions in accordance with the FCA's record retention requirements and to support best execution analysis.	4.3%
	In view of the nature of the requirement, the quality of the service delivery was recognised as being crucial and therefore more important than the cost.	
Evaluation Team	Written Tender Submissions: Officers from LPF x 3 Tenderer Demonstrations / Presentations: Officers from LPF x 4	

Actuarial Services

Summary of Tendering and Tender Evaluation Processes

This specialised service requirement can only be delivered by appropriately qualified organisations. Lot 1 of the existing 'LGPS Framework for the Provision of Actuarial, Benefits and Governance Consultancy Services' (ref. NCCT40954), administered by Norfolk County Council, addresses this specific requirement.

The term of the proposed new contract will be from 1st January 2019 for an initial period of 4 years, with options to extend for a further period of 3 years, giving a total potential contract period of 7 years.

The total value of the proposed contract, including extensions, is currently estimated at £922,512.

At this point, based upon LPF's anticipated future requirements, the cost of the contract for the initial 4 year period will be approximately £527,150.

This equates to an estimated average annual cost over the initial 4 year period of £131,787. This includes the provision of one triennial actuarial valuation which distorts an annual comparator of cost. Some actuarial services incurred by Lothian Pension Fund are recharged to employers in accordance with the Funding Strategy Statement. Such cost recovery is estimated at £34,050 per annum.

It is emphasised that the range of actuarial services is wide and estimate of future volumes for specific chargeable services is subjective.

Tender Process and Scores Awarded

A total of 4 potential suppliers are currently registered / available on Lot 1, their applications having been successful when the Framework was launched in 2016.

In accordance with the terms of the Framework, all 4 suppliers were invited to participate in a further mini-competition in order to identify the most appropriate tender. The invitation gave those suppliers 30 days in which to prepare and submit their tender bids.

Three organisations submitted tender bids. Technical evaluation of the bids was conducted on the 'Most Economically Advantageous Tender' (MEAT) basis, with 40% of the overall evaluation score given to Quality, 30% to Service Fit and 30% to Price.

Initial evaluation of the Quality of all written tenders received was undertaken by a panel comprised of three officers from LPF. Following this, each tenderer was required to deliver a presentation in order for the panel to evaluate their Service Fit.

The following table gives a summary of the scores awarded to each of the bids received:

Organisation	<u>Quality</u> Weighted Score (max 40%)	<u>Service Fit</u> Weighted Score (max 30%)	<u>Price</u> Weighted Score (max 30%)	<u>Total</u> Weighted Score
Hymans Robertson LLP	40.0%	29.0%	22.0%	91.0%
Tenderer 2	19.6%	19.0%	18.31%	56.91%
Tenderer 3	17.2%	14.5%	16.38%	48.08%

The table below provides a further summary of the tendering/tender evaluation process:

Contract	Actuarial Services for Lothian Pension Fund	
Contract period (including any extensions)	1 st January 2019 to 31 st December 2025 (including potential extension period of 3 years – a total of up to 7 years).	
Estimated contract value	£922,512 (based upon current requirement, including possible extensions).	
Procurement route chosen	Mini-competition from current 'LGPS Framework for the Provision of Actuarial, Benefits and Governance Consultancy Services' (ref. NCCT40954)	
Tenders returned	3	
Recommended supplier	Hymans Robertson LLP	
Price / Quality Split	Quality: 70% (comprised of 40% quality of written tender submission / 30% presentation re Service Fit) Price: 30%	
Evaluation criteria and weightings and reasons for this approach	Criteria - Written Tender Submission Topics	Weighting
	1. Reporting	8.0%
	2. Resources	10.0%
	3. Timescales	6.0%
	4. Transition	6.0%
	5. Data & Administration	10.0%
	Criteria - Tenderer Presentation Topics	
	1. A resourcing plan with details of specific people (including CVs) who would be supporting the Funds	5.0%
	2. Knowledge and experience with similar sized pension funds	2.5%
	3. Approach to the 2020 Valuation	20.0%
	4. Tools available to Lothian Pension Fund	2.5%
	In view of the nature of the requirement, the quality of the service delivery was recognised as being vital and therefore more important than the cost.	
Evaluation Team	Officers from LPF x 3	