

ACCESS UPDATE – RENT vs BUILD AND OWN AN OPERATOR

Report of the Director of Resources

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1. Purpose of the Report

- 1.1 To provide the Pensions Committee with a summary and the conclusions from the ACCESS Chairs meeting which took place on the 2 September. The purpose of this meeting was to decide on whether to rent or build and own an operator.

2. Summary

- 2.1 The Chairs of the ACCESS pool met on 2 September to review the analysis and the proposed conclusions from the work undertaken by officers in considering whether to build and own its own investment company (operator) or rent one from a third party. This paper sets out some of the pro/cons of rent vs build and the recommendation reached by the Chairs for agreement by their respective pension committees.

3. The Collective Investment Vehicle (CIV) Operator

- 3.1 In its submission to Government in July, ACCESS proposed to establish a Financial Conduct Authority (FCA) authorised Collective Investment Vehicle (CIV) consisting of:
- An FCA authorised pooled fund **Operator¹**; and
 - A regulated investment vehicle to house assets.
- 3.2 The CIV operator is a single legal entity which is either owned by the Funds in the pool, or rented from a third party operator. Within the Operator there are a number of FCA regulated roles such as the Chief Investment Officer (CIO), and the Chief Risk Officer (CRO). ACCESS authorities have no current capacity or capability internally to fulfil the roles required by the FCA.

¹ Aka Alternative Investment Fund Manager (AIFM)

- 3.3 The Operator is responsible for setting up and running the pooling vehicles that house the assets i.e. equities, bonds etc. Responsibilities of the Operator include but are not limited to the following:
- investment management arrangements;
 - obtaining FCA regulation for the pooled vehicles;
 - risk management;
 - dealing in underlying investments;
 - valuation;
 - determining unit prices of pooled investments;
 - portfolio accounting and client reporting; and
 - setting policies for unit pricing, liquidity, risk management.

4. Evaluation factors

- 4.1 As part of the assessment of the two options officers commissioned legal opinion from Eversheds and met with potential third party operators such as Capita and Mercer. In addition, Capita attended the Chairs meeting on 2 September to explain the role of an operator and the responsibilities of this role.
- 4.2 A number of factors were considered by ACCESS officers when reviewing the two options available for their operator and putting forward a recommendation for the ACCESS Chairs to consider and decide upon. The table below sets out the key factors under consideration.

Factor	Build & Own	Rent
Regulatory risk	Fines and penalties for regulatory breaches and reputational risk.	Regulatory and operational risk transferred to operator.
Governance - accountability	Shareholder control	Can move to another third party provider or own in the future.
Governance – manager selection	Operator legally appoints investment managers but consults clients who can recommend managers.	Same
Long term	Shareholder control enables changes in functionality and services if required.	Would need to renegotiate specification if changes required. Could replace 3 rd party operator with owned operator in the future.
Timescale to implement	Potentially 18-24 months	Potentially 12-18 months.
Market	Staff recruitment,	May be limited providers

	salaries and retention of important people in the team.	in market – needs to be tested.
Supplier risk	Likely to outsource a number of functions.	Reliant on third party providers requiring robust contracts and service level agreements.
Cost to establish and run	Set up – est. £3-5m Ongoing – est. £3-5m per annum	Set up costs – legal and procurement only. Ongoing – similar in short term but could be higher in the longer term if fees based on AUM. ²

- 4.3 One of the key findings that officers drew from their evaluation of the two options was that it would be possible to build and own an operator but it would be difficult to implement and would be heavily dependent on third party suppliers. FCA regulated roles would need to be recruited and appointed to, risk control and reporting systems would need to be acquired, IT support systems and accommodation would be needed as well as support staff. Building and owning an operator will also bring all the regulatory risk on to the administering authorities as shareholders and individuals as directors. Over the long term the owned operator might cost less than renting an operator.
- 4.4 The recommendation put forward by officers was to rent an operator initially but allow flexibility to continue to rent in the future or change to an owned operator. Factors that will or may affect views in the future include:
- experience of renting;
 - the future market for third party suppliers;
 - running costs of rental; and
 - Needs of Funds.

5. Chairs discussion and decision

- 5.1 The Chairs discussed the officer findings and debated the recommendation to rent an operator. There was an in depth discussion of the possible role of Pension Committee chairs in the future appointment of investment managers under both options as the initial perception was that they would not be involved in the process under the rental option. The session with representatives from Capita, who included their Chief Investment and Risk Officers, reassured Chairs that under the rental option they would be able to make investment manager recommendations to the operator. The operator would then undertake due diligence on these managers and if this was satisfactory appoint and contract with the managers. This had been an area of concern for some Chairs in that they thought that their Committees may no

² AUM – assets under management

longer be involved in the appointment process for managers. Under both rent and own options the operator is the party that will appoint and contract with the investment managers.

- 5.2 The Chairs also discussed regulatory risks and the fines that could be imposed by the FCA on an operator for non-compliance and breaches; these fines could be on the regulated individuals who work for the company or the company itself. The officers from Capita were able to provide some examples of these risks and the controls that would need to be in place to mitigate them.
- 5.3 The Chairs acknowledged that the rental option appeared more straightforward to implement over a shorter time scale, cost less initially and transferred more risk to the operator. Some Chairs expressed the view that over the longer term they would like the flexibility to move to an “owned” operator option and wanted a timetable built into the plan to review the rental model after a few years with the potential to move to an owned operator model. Capita officers provided examples of how they have experience of facilitating this sort of transition including helping support knowledge transfer to officers in setting up an owned operator as long as their costs were covered over the contract term.
- 5.4 The Chairs unanimously agreed in principle to rent an operator initially but allow flexibility in the future to continue to rent or change to an owned model if there was a case for doing so in the future.

6. Recommendation

- 6.1 The Pension Committee agrees the recommendation by the ACCESS Chairs to rent an operator with the flexibility to move to an owned model in the future.