

## **PENSIONS COMMITTEE – 25 NOVEMBER 2004**

### **COMMISSION RECAPTURE AND STOCK LENDING**

#### **SUMMARY**

This report sets out proposals to reduce the level of commission paid by the Pension Fund to brokers for the buying and selling of shares and to generate additional income from stock lending.

#### **RECOMMENDATIONS -That**

- (1) An agent be appointed to implement commission recapture.
- (2) The Director of Finance and Business Services, in consultation with the Assistant Director (Legal Services), be authorised to enter into negotiations for stock lending arrangements.

#### **1. Introduction**

Commission recapture and stock lending are two methods available to the Fund to reduce fees and generate additional income.

Commission recapture uses an agent to collect and return to the fund a percentage of the brokerage commission paid by the fund managers. This is a specialised service with few market providers and appointment of a service provider will not require a tendering process. The Myners review highlighted transaction costs as a key issue therefore consideration of this issue will conform to our Statement of Investment Principles (SIP).

Stock lending is the practice of lending shares to a third party who must eventually return the same shares as repayment. Traders may need to borrow stock if, as part of their trading strategy, they sell more stock than they hold at that time.

Further details are given below.

#### **2. Commission Recapture**

Fund managers pay commission to brokers to facilitate the buying and selling of stocks and shares. A generally accepted industry practice is for part of the commission paid to cover an element for work undertaken by the broker in researching the particular stock and for the provision of market information. Commission Recapture rebates to the Fund a portion of the commission so that the fund is only paying for the buying and selling of the stock. Essentially commission recapture is a brokerage discount that is collected as cash and returned to the Fund.

In order to access the commission rebate, the Council would appoint an agent through whom the Managers would divert a specified portion of their transactions,

usually about 25%. Directing more than this may compromise the ability to achieve best price when dealing. The agent receives a small commission from the broker. All administration is completed between the agent and the Fund managers with the Fund manager responsible for providing data to the agent for reconciliation purposes. Both UBS and Newton are able to participate in commission recapture.

It is estimated that about £20,000 per year will be saved.

### **3. Stock Lending**

Stock lending is a process where stock market traders may need to borrow stock if, as part of their trading strategy, they sell more stock than they hold. As part of this process full beneficial and legal ownership of the stock is transferred and the borrower provides collateral (eg government or public securities) of at least equal value (adjusted daily).

For the duration of the loan the lender is due all entitlements such as dividends, interest due and corporate actions but forgoes voting rights unless the shares are recalled in good time. At the end of the process, the stock is returned to the lender.

Under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended) the fund may stock lend up to a maximum of 25% of the fund's value. There is currently a consultation proposal to extend this to 35%.

The majority of custodians who offer a stock lending service effectively eliminate all risks, such as failure to return stock or pay entitlements, by fully indemnifying their clients. If approved, the Fund would seek to enter a fully indemnified stock lending arrangement.

The Bank of New York, the custodians of Newton's half of the Fund, do not currently enter into stock lending arrangements. UBS are in the process of out-sourcing their custody service. Negotiations could commence with the new custodian when they are appointed.

No charge is made by the stock lending service provider (custodian), who retains a percentage of the stock lending proceeds. It is estimated that stock lending would generate around £30,000 additional income per year for the fund.

#### **Local Government Act 1972 – section 100d**

#### **List of background documents**

UBS Investment Reports – October – December 2003  
Newton Pension Fund Disclosure Reports – January - December 2003  
Lynch, Jones & Ryan publications  
Pensions Week edition 26<sup>th</sup> April 2004 - "The odds are in schemes' favour"  
FSA Consultation Paper 176 - "Bundled Brokerage and Soft Commission Arrangements"  
WM Company Performance Reports – September 2003 and March 2004

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