# Pensions CIV Sectoral Joint Committee Agenda

## 8 February 2017 – 10:30am – 12:30pm

Conference Suite (1st Floor)

At London Councils offices, 59½ Southwark St., London SE1 0AL
Refreshments will be provided
London Councils offices are wheelchair accessible

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| **Labour Group pre-meeting:** | Room 1 (1st Floor) | 09:30am |
| (Political Adviser: 07977 401955) | | |
| **Conservative Group pre-meeting:** | Room 5 (1st Floor) | 10:00 am |
| (Political Adviser: 07903 492195) | | |

**Contact Officer:** Alan Edwards

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## Agenda item Page

| | | |
|---|---|---|
| 1 | Apologies for Absence and Announcement of Deputies | |
| 2 | Declarations of Interest* | |
| 3 | Minutes of the Meeting held on 13 December 2016 | |
| 4 | London CIV 2017/18 Budget and Medium Term Financial Strategy | |
| 5 | London CIV 2016/17 Financial Report | |
| 6 | Investment Advisory Committee Update | |
| 7 | [item moved to E2] | |
| 8 | CIV Stewardship Update | |
| 9 | London CIV Fee Recovery From Passive Investments | |
| 10 | Markets in Financial Instruments Directive 2 (MiFID2) | |
| 11 | London CIV Governance Review | |

***Declarations of Interests**

If you are present at a meeting of London Councils' or any of its associated joint committees or their sub-committees and you have a disclosable pecuniary interest* relating to any business that is or will be considered at the meeting you must not:

- participate in any discussion of the business at the meeting, or if you become aware of your disclosable pecuniary interest during the meeting, participate further in any discussion of the business, or
- participate in any vote taken on the matter at the meeting.

These prohibitions apply to any form of participation, including speaking as a member of the public.

It is a matter for each member to decide whether they should leave the room while an item that they have an interest in is being discussed. In arriving at a decision as to whether to leave the room they may wish to have regard to their home authority's code of conduct and/or the Seven (Nolan) Principles of Public Life.

*as defined by the Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012

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The Pensions CIV Sectoral Joint Committee will be invited by the Chair to agree to the removal of the press and public since the following items of business are closed to the public pursuant to Part 5 and Schedule 12A of the Local Government Act 1972 (as amended):

Paragraph 3 - Information relating to the financial or business affairs of any particular person (including the authority holding that information), it being considered that the public interest in maintaining the exemption outweighs the public interest in disclosing it.

| Exempt Agenda item | | Page |
|---|---|---|
| E1 | Exempt Minutes of the meeting held on 13 December 2016 | |
| E2 | Investment Report and Fund Update | |

# Pensions CIV Sectoral Joint Committee (PSJC)
# 13 December 2016

Minutes of a meeting of the Pensions CIV Sectoral Joint Committee held on Tuesday 13 December 2016 at 10.30am in the Conference Suite, London Councils, 59½ Southwark Street, London SE1 0AL

**Present**:

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|---|---|
| City of London | Mark Boleat (Chair) |
| Barking and Dagenham | - |
| Barnet | Cllr Mark Shooter |
| Bexley | Cllr Louie French |
| Brent | Cllr Sharfique Choudhary |
| Bromley | - |
| Camden | Cllr Rishi Madlani |
| Croydon | Cllr Simon Hall |
| Ealing | Cllr Yvonne Johnson |
| Enfield | Cllr Derek Levy (deputy) |
| Greenwich | - |
| Hackney | Cllr Roger Chapman |
| Hammersmith and Fulham | - |
| Haringey | - |
| Havering | Cllr John Crowder |
| Harrow | - |
| Hillingdon | Cllr Philip Corthorne |
| Hounslow | Cllr Mukesh Malhotra |
| Islington | Cllr Richard Greening |
| Kensington and Chelsea | - |
| Kingston Upon Thames | Cllr Roy Arora (deputy) |
| Lambeth | - |
| Lewisham | Cllr Mark Ingleby |
| Merton | - |
| Newham | Cllr Forhad Hussain |
| Redbridge | - |
| Richmond Upon Thames | Cllr Thomas O'Malley |
| Southwark | Cllr Fiona Colley |
| Sutton | - |
| Tower Hamlets | Cllr Clare Harrisson |
| Waltham Forest | Cllr Simon Miller |
| Wandsworth | Cllr Maurice Heaster |
| City of Westminster | Cllr Sulhail Rahuja |

**Apologies:**

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|---|---|
| Barking and Dagenham | Cllr Dominic Twomey |
| Bromley | Cllr Teresa Te |
| Enfield | Cllr Toby Simon |
| Greenwich | Cllr Don Austen |
| Hammersmith & Fulham | Cllr Iain Cassidy |
| Haringey | Cllr Clare Bull |
| Harrow | Cllr Nitin Parekh |
| Hillingdon | Cllr Philip Corthorne |
| Kingston Upon Thames | Cllr Eric Humphrey |
| Redbridge | Cllr Elaine Norman |
| Sutton | Cllr Sunita Gordon |

Officers of London Councils were in attendance as were Lord Kerslake, Chair of the Pensions CIV Board, Hugh Grover (CEO, London CIV), Julian Pendock (CIO, London CIV), Brian Lee (COO, London CIV), Jill Davys (AD Client Management, London CIV), and Ian Williams (Chair, Investment Advisory Committee).

**1. Announcement of Deputies**

1.1. Apologies for absence and deputies were as listed above.

**2. Declarations of Interest**

2.1. There were no declarations of interest that were of relevance to this meeting.

At the start of the meeting the Chair, Mr Mark Boleat provided feedback from a recent (12 December) meeting with Mr Marcus Jones MP Parliamentary Under-Secretary of State (Department for Communities and Local Government, Minister for Local Government). He noted that in attendance had been himself, Cllrs Johnson, Heaster and Gordon, Lord Kerslake, Hugh Grover and Ian Williams. He reported that key themes from the Minister had been:

- The Government's ongoing commitment to the overall LGPS pooling policy;
- Reinforcement of the Government's desire to see more investment in infrastructure. On which the Chair made a general point about funding infrastructure, that the issue was not finding finance for infrastructure but finding infrastructure for finance;
- A hope that progress would be made further and faster; and
- Enthusiasm for collaboration between pools.

In response the London CIV side had stressed the costs associated with regulation in the hope that the minister may be able to do something about it.

Chair of the Board, Lord Kerslake affirmed that London was ahead of most, if not all, CIVs elsewhere in the country. On infrastructure, he pointed out that the Government was keen for the CIV to invest in infrastructure but without any detail about precisely how this would be done. He noted that a follow up letter was expected and would be circulated.

**3. Minutes of the Meeting held on 18 October 2016**

3.1. Cllr Rishi Madlani pointed out that ESG Criteria had been omitted from item 6 in the minutes.

3.2. With that change made, the minutes of the PSJC meeting held on 18 October 2016 were agreed.

**4. Global Equity Procurement Update**

4.1. The CIO introduced the item saying the CIV Investment Team, working alongside the Global Equity Sub-Group (drawn from local authority colleagues of the Investment Advisory Committee (IAC)) had been progressing with the global equity procurement. In total some 57 clarification meetings had been held with prospective fund managers, covering nine global equity strategies. A final preferred list would be discussed with the IAC and the Joint Committee. In addition, London Funds had been completing a survey to assess their current requirements in the global equity space, in order to decide which sub-funds should be opened first. He had been encouraged that most managers had claimed to be charging the lowest ever fees.

4.2. In response to questions from Cllr Richard Greening about the ability to move from one fund manager to another and the need to look at investing in infrastructure and housing the CIO replied that the difference between those fund managers that were being brought on and those that were in procurement could be made clear, that the IAC Fixed Income sub-group would be bringing forward ideas covering cashflow generating products and that infrastructure meant different things to different boroughs.

4.3. The CEO said that a survey of the London LGPS Funds had been undertaken to help enhance current understanding of likely equity fund requirements which would help to determine which of the nine strategies was put forward for development of new funds and the timeframe for doing so. Due diligence would be conducted on all the managers where sub-funds were going to be opened and commercial negotiations finalised. In response to a question from Cllr French about whether fresh due diligence was needed, the CEO replied that it was.

4.4. The Committee agreed to note the report.

**5. Investment Advisory Committee Update**

5.1. The CEO introduced the Chair of the Investment Advisory Committee (IAC) Mr Ian Williams who introduced the report as follows:

- He thanked the number of boroughs that had contributed officer time, and the officers themselves for all their hardwork and commitment;
- He noted that current work was being taken forward through sub-groups on: Global equities, fixed income and cashflow, stewardship, infrastructure, housing and reporting: and
- He was encouraged by the progress being made and the involvement of boroughs in the global equity procurement process which was going well.

5.2. In response to a point made by Cllr Mukesh Malhotra about who individual members were on committees and how they came to be appointed, he undertook to circulate a list and reported that members of the IAC were principally selected by election or nomination and that the selection process was managed by borough treasurers through the Society of London Treasurers.

5.3. The Chair reported that the borough Treasurers had proposed a governance review which would include the role and terms of reference of the Investment Advisory Committees.

5.4. Cllr Richard Greening pointed out that Fixed Income was an asset class that had changed in risk profile and that perhaps infrastructure should be prioritised instead of it. The CEO assured that priorities could be revisited. He went on to point out that one reason to concentrate on bigger asset classes was to grow the quantum of assets under management to shift the funding of London CIV from the annual service charge, which would need to be increased for the next few years, to fee income from the fund, and there was not a great amount of assets going into infrastructure at the current time, hence its lower priority. The CIO drew attention to the 'litany of woes' in the Fixed Income market which was something that was being considered by the Fixed Income sub-group.

5.5. Cllr Fiona Colley argued that Global Equity funds would not be ready when investments were ready to be made and the CEO said that the process to open a sub-fund was more complex than had been anticipated and with preparatory legal work it was taking 3-4 months to open a fund, including a month to obtain FCA authorisation. He was conscious that boroughs may have to move before all asset classes were ready and assured that every effort was being made to speed up the fund opening process.

5.6. The Committee agreed to note the report.

## 6. Constitutional Matters

6.1. Christiane Jenkins, the London Councils' Director of Corporate Governance introduced the report saying:

- All 33 London local authorities had now adopted a similar form of resolution to facilitate their participation in the London LGPS CIV Limited and the London Councils Pension CIV Sectoral Joint Committee (PSJC)
- The authorities agreed in taking those resolutions that, should all 33 London local authorities resolve to participate in the arrangements, Leaders Committee should exercise those functions, instead of the sectoral joint committee which is restricted to having a maximum of 32 members under the London Councils (Leaders') Committee Governing Agreement, and the Governing Agreement should be varied accordingly.

6.2. Lord Kerslake noted that this was a product of the success of signing up all the boroughs and he hoped that the CIV committee would continue in some form.

6.3. In response to a question from Cllr Malhotra, the CEO confirmed that all participating local authorities had contributed the same amount of funding and share capital.

6.4. Cllr Rishi Madlani pointed out that if all 33 Variations to the Agreement were signed tomorrow the committee would stand dissolved and steps should be taken to ensure that this did not happen immediately and thought needed to be given to what representatives would be involved, pensions committee chairs, trade unions.

6.5. The Committee agreed to note:

- that following a decision of the 33rd London local authority to delegate the exercise of sections 1 and 4 of the Localism Act 2011 for the purpose of participating in the London Councils Pension CIV Sectoral Joint Committee (PSJC), a formal agreement varying the London Councils Governing

Agreement would be prepared and sent to each London local authority to incorporate into that Agreement the functions which Leaders' Committee would instead jointly exercise on behalf of all 33 authorities

- that the Pensions CIV Sectoral Joint Committee would be dissolved upon the formal variation being entered into by all 33 participating local authorities
- that until such time as all the participating authorities had returned the signed variation, that the Pensions CIV Sectoral Joint Committee would continue to exist and meet.

The meeting resolved to exclude the press and public.

The meeting closed at 11.15 am

# Pensions CIV Sectoral Joint Committee

Item no: 4

## London CIV 2017/18 Budget and MTFS

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|---|---|---|---|
| **Report by:** | Hugh Grover | **Job title:** | Chief Executive, London CIV |
| **Date:** | 8 February 2017 | | |
| **Telephone:** | 020 7934 9942 | **Email:** | hugh.grover@londonciv.gov.uk |

**Summary:** As required by the Shareholders Agreement this report provides the committee with London CIV's budget proposals for 2017/18 and the medium term financial strategy for the following years through to March 2022.

**Recommendations:** The committee is recommended to consider the contents of this report and to agree to London CIV's 2017/18 budget.

# London CIV 2017/18 Budget and MTFS

**Introduction**

1. Members will be aware that the London CIV Shareholders Agreement (to which all participating London Local Authorities (LLAs) and London CIV are signatories) requires that London CIV's annual budget be submitted for approval by the Shareholders. This report and the attached 2017/18 budget fulfils that requirement and goes beyond to also include a medium term financial strategy (MTFS) covering the financial years through to March 2022.
2. The budget and MTFS have been prepared by London CIV's Executive team and approved for submission to shareholders by London CIV's Board.
3. For clarity, Members are reminded that London CIV is committed to an annual budget cycle and thus only the 2017/18 budget requires formal agreement at this time. The MTFS for following years is provided to give Members clarity about London CIV's future plans and how the growth of assets under management interacts with funding requirements.
4. Members will note that the budget and MTFS have been based on 32 participating LLA LGPS funds. This is because although all 33 funds have now become participating members, LB Richmond and LB Wandsworth are in the process of merging their two funds into one combined fund that will be administered by LB Wandsworth. It is not yet clear at this point what the implications of the merger will be for London CIV, but it may be that income and capital will revert to being available from 32 authorities rather than 33. Thus 32 has been used as the prudent position for budgeting at this point. Legal advice is being sought on the implications of the merger, but for clarity, London CIV has no specific view on the likely or desirable outcome.
5. The Board is grateful to the Joint Committee Chair and Group Leaders, and the Treasurers from the Investment Advisory Committee, for the robust and constructive challenge and guidance they have provided.
6. To facilitate discussions at the local level LLA Treasurers have been provided with copies of this report.
7. An invoice for the proposed Service Charge and Development Funding Charge will be issued to each LLA at the beginning of the financial year.

**Recommendations**

8. The committee is recommended to consider the contents of this report and to agree to London CIV's 2017/18 budget.

**Legal Implications**

9. There are no legal implications for London Councils.

**Financial implications**

10. There are no financial implications for London Councils.

**Equalities Implications**

11. There are no equalities implications for London Councils

**Attachments**

12. London CIV 2017/18 Budget and Medium Term Financial Strategy

# 2016/17 Budget and Medium Term Financial Strategy

January 2017

## Contents

## 1. PURPOSE

This document sets out the following:

- the revised budget forecast for financial year ending March 2017 as agreed by shareholders in December 2016;
- the annual budget as required by the LCIV Shareholder Agreement for the financial year ending March 2018; and
- the Medium Term Financial Strategy (MTFS) covering the annual financial plan for the five years from April 2017 to March 2022.

London CIV's (LCIV) Board has set the strategic direction for the company which is supported by this budget and MTFS. The document has been drafted by the company's Executive team and has been approved by the Board. Day-to-day delivery against the budget is the responsibility of the Executive team which, as with any budgetary process, will require flexibility on managing the detail to ensure that the objectives can be achieved within the overall budgetary framework.

## 2. CONTEXT

The London CIV journey began back in 2012 with proposals being presented to London Councils' Leaders' Committee that would have led to the complete merger of all of London's 34 Local Government Pension Scheme (LGPS) funds (boroughs, City of London and the London Pension Fund Authority). These proposals were not adopted and instead Leaders' Committee commissioned London Councils officers to facilitate the development of ideas that would deliver most, if not all, of the benefits of merger without the cost, complexity and loss of sovereignty and democratic oversight that would result from merger.

Proposals were developed by a working group comprised of the then London Councils political group leaders and three representative treasurers, which were reported back to Leaders' Committee. In brief those proposals were that:

- A London LGPS Collective Investment Vehicle (CIV) should be set up in the form of an Authorised Contractual Scheme fund (ACS);
- A new company, wholly owned by the participating authorities, should established to act as operator of the CIV; and
- Participation of the separate London LGPS funds should be entirely voluntary, with responsibility for investment strategy and asset allocation staying at the local level, while responsibility for the appointment and management of external fund managers and the general management, performance and oversight of the ACS fund would rest with the operator.

At the same time that these regional proposals were being developed, discussed and agreed the Government was actively considering the future structure of the LGPS nationally and began to make proposals to bring about complete merger across the scheme into a smaller number of funds. However, the work being done across London was in large part successful in demonstrating that voluntary collaboration could be delivered and that, as originally aimed for, substantial benefits could be delivered without the need for merger.

In November 2015 the Government published a document 'LGPS: Investment Reform Criteria and Guidance' setting out policy for all LGPS funds across England and Wales to develop pools along similar lines to London CIV. The funds were instructed to submit "ambitious proposals" for the establishment of a small number of investment pools based on the requirement that every fund must join with a pool and invest the majority of its assets through that pool over a period of time. This direction from Government effectively changed the environment for London funds and London CIV from being engaged in an entirely voluntary collaboration to a more mandatory position.

It is within this changing regional and national policy framework that London CIV has been established and now operates

## 3. EXECUTIVE SUMMARY

Since FCA authorisation in October 2015, LCIV has launched 6 sub-funds with £3.1 Bn assets under management (AUM) across 14 boroughs (as of 31 December 2016). LCIV resources have been expanded from three to eleven including recruitment of the LCIV Executive Management team and the organisation has worked with stakeholders to establish an effective partnership which is critical to the success of the organisation. Both the scale of AUM achieved in the first twelve months and the operational progress are a considerable achievement.

During the first year of operation, a number of key lessons have also been identified and it is clear that what LCIV has to deliver as a regulated fund manager, providing excellent client service with potentially £25 Bn of assets under management (AUM) across multiple asset classes, is more challenging than had been envisioned.

The challenges faced by London's LGPS funds, as for most of the world's pension funds, are significant and growing. LCIV has to deliver benefits beyond cost savings from scale economies and address the fact that many Pension Fund's strategic asset allocations will increasingly tilt towards asset classes which require scale and in-house expertise. This will inevitably mean higher up-front costs to ensure LCIV has the requisite skills required to deliver the investments investors will require, but ultimately should result in cash and non-cash benefits of a far greater magnitude than originally envisaged.

A key imperative for LCIV and its investors/shareholder to progress from being a delivery platform for voluntary collaboration of London local authorities (LLAs) to a fully established fund management company able to deliver investor benefits in the widest sense, is to ensure the transfer of assets is completed as quickly as possible as a higher AUM base will:

- lead to faster delivery of greater fee savings;
- allow LCIV to efficiently offer a broader range of investment products; and
- allow LCIV to cover its costs and be less reliant on additional LLA funding.

**2016/2017 Budget**

The status of the annual budget for 2016/17 was reviewed and approved by the shareholders at the General Meeting of the Company held on 13th December 2016. The budget forecast £1.5Mn in revenues, £2.3 Mn operating expense and a deficit of near £800K. The shareholders agreed that the 2016/17 deficit would be covered by existing capital reserves, which would be recovered in future years as LCIV moves to profit and balance balanced budget.

**2017/2021 Forecast and Plans**

During the next phase of LCIV's development in the period 2017-2021 as it moves from set up through implementation to full 'business as usual' (BaU), LCIV's key priorities are to:

- Continue to work closely with the LLAs to respond to their investment needs and ensure the opportunities LCIV identifies across Global Equities, Fixed Income, and other cash flow-generating asset classes such as Real Estate, Infrastructure and other "alternative" asset classes, will meet those needs;
- Expand LCIV's staff complement in the front, middle and back office to bring on board the necessary capacity, knowledge and skills to deliver the different asset classes, volume of planned fund launches, and ensure that the company can fulfil its fiduciary responsibilities;
- Establish scalable, fit for purpose, system and process capabilities for client reporting, performance management reporting, and risk management; and
- Develop clear and transparent communications with LLAs and stakeholders.

**AUM and Revenue Forecast**. The plan includes a broadening of asset classes during 2017-2021 with the launch of Global Equities and Fixed Income funds in 2017/18 and 2018/19, Real Estate in 2018/19 and 2019/20, and Infrastructure and Alternatives in 2019/20. Overall, as a result of this expansion the number of sub-funds is likely to increase from 6 to 28 under current assumptions, leading to a forecast increase in AUM from £3.2 billion in March 2017 to £14.1 billion by March 2022. This is equal to 49% of the £29.2 Bn total LLA assets (as of March 2015). Based on the projected AUM growth and other current assumptions, management fees are forecast to grow from £640K at end 2016/17 to £3.9 Mn by end 2021/22.

As it is difficult for LCIV to accurately forecast AUM growth and resulting management fees as decisions to transition assets reside with the LLAs, a number of revenue and cost scenarios have been modelled (working with a sub-group of LLA Treasurers) before finalising the proposed Annual Budget. With the budgeted AUM growth, LCIVs management fees are unlikely to cover annual operating costs over the planning period and additional funding will be required.

It is important to point out that based on LCIVs estimates approximately 60% of 2017/18 expenditure will be focused on fund launches and development projects, with only 40% being targeted on recurring activities or BaU. This ratio of fund launch/development projects to BaU expenditure is forecast to change gradually over the planning period shifting to 10% fund launch/development projects and 90% BaU spend in 2021/2022.

In order to cover the cash flow imbalance between annual revenues and annual costs, LCIV is proposing to introduce a development funding charge (DFC) until LCIV generates sufficient management fee income to cover annual operating costs. The DFC would be in addition to the annual service charge and will decline year on year starting at £75,000 in 2017/18 and reducing to £10,000 in 2021/22 as AUM and management fees rise over the five years.

On 16 December 2016 Marcus Jones MP (Minister for Local Government) wrote to Lord Kerslake, Chair of LCIV, following a meeting to discuss the joint submission of LCIV and the LLAs to government in July 2016. In his letter the Minister noted that, in the government's view, the current forecasts and transition of assets into the LCIV pool will be "unacceptably slow".

Using a more optimistic AUM growth scenario where £19.4 Bn or 67% of the £29.2 Bn LLA assets are transferred to LCIV by March 2022, the DFC would drop to £25,000 in 2019/20 and LCIV would become self-funded through management fees and the annual service charge in 2020/2021, two years earlier than the current plan.

**Expense Forecast**. Given the expansion in the variety of asset classes and sub-funds, additional resources and systems are required to support:

- the number and variety of funds;
- ongoing investment oversight and risk management; and
- client, financial, and regulatory reporting.

On this basis, total expenses are forecast to increase from £2.3 Mn in 2016/17 to £4.9 Mn in 2019/20 driven by:

- an increase in staffing levels from 11 to 25 over the planning period, which accounts for more than 50% of the cost base;
- investment in client reporting, performance management and risk systems; and
- legal and professional fees associated with sub-fund launches, particularly new asset classes which will require new legal structures and front and back office operating processes to be developed.

**Capital Expenditure**. The forecast includes a total capital expenditure of £150,000 in 2018/19 which is comprised of:

- £100,000 for ICT equipment to improve IT resilience, and functionality, which will be depreciated over 3 years; and
- an allowance of £50,000 for fixtures and fittings to fit out expanded accommodation which will be depreciated over 3 years.

**Enterprise Risks.** LCIV Board and Executives have reviewed the risks associated with delivering the 2017/18 plans and identified the key Enterprise Risks, mitigation plans and key risk indicators as outlined in the Enterprise Risk Register, Fig 11. These risks will be monitored on an ongoing basis and status reported quarterly to the Board and stakeholders.

**Performance Reporting.** LCIV will provide quarterly reports on performance of its funds, annual and half yearly report and accounts and regular newsletter updates. In addition, LCIV's Executive team will provide an update to the Board and stakeholders on progress against the business plan's 2017/18 objectives, including fund launches, financial performance and forecast for the remainder of the financial year and risks.

## 4. LONDON CIV STRATEGIC FRAMEWORK

LCIV's strategic framework outlines the core purpose of the organisation, its vision, and the value proposition to the LLAs.

**Purpose.** LCIV's purpose is to create a collective investment vehicle for London Local Authority (LLA) Pension Funds which delivers broader investment opportunities and enhanced cost efficiencies than LLAs can achieve individually and overall better risk-adjusted performance.

**Vision.** LCIV aims to be the vehicle of choice for Local Authority Pension Funds through successful collaboration and delivery of compelling performance

**Value Proposition.** The LCIV value proposition to the LLAs focuses on:

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|---|---|
| ***Performance:*** | providing superior risk adjusted investment outcomes by leveraging scale economies and full-time resources focused purely on investment management |
| ***Opportunity:*** | providing a broader range of investment opportunities than might be accessible by an LLA acting alone |
| ***Efficiency:*** | providing cost effective investment products through leveraging the scale of LLA pooled assets and being an efficient organisation |
| ***Transparency:*** | providing transparent reporting across investment performance, client reporting, risk management and client benefits |

**LCIV Objectives.** Below are LCIV's Aims and 2017/18 Objectives and KPIs.

**LCIV Aims**

**Investments and Investment Oversight**

- Deliver cost effective investment solutions which enable the LLA Pension Funds to meet their investment objectives
- Demonstrate and deliver effective investment oversight appropriate for a large scale regulated investment vehicle

**Client Service**

- Provide excellent client service
- Deliver identified client cost savings benefits
- Deliver transparent, regular and effective reporting to clients and stakeholders

**Finance and Business Operations**

- Achieve target AUM levels and revenues
- Maximise operational and cost efficiencies
- Establish a high-performing learning organisation

**Governance, Risk and Compliance**

- Deliver LCIV's value proposition within an effective governance structure
- Remain an enterprise risk managed and compliant company

**LCIV 2017/18 Objectives**

**Investments and Investment Oversight**

- Complete launch of identified and agreed commonality funds
- Launch Global Equity and Fixed Income fund strategies as prioritised in collaboration with LLAs and supported by a business case and transparent benefits
- Deliver quarterly investment oversight dashboard monitoring mandate drift and performance and taking proactive action where required

**Client Service**

- Complete assessment of LLA needs based on triennial valuation results
- Agree client reporting and service model and implement including SLA
- Establish robust and transparent benefits reporting by LLA

**Finance and Business Operations**

- Manage costs in line with approved budget
- Finalise target operating model and complete implementation of core systems
- Deliver staff recruitment plan
- Meet LCIV Board and stakeholder MI and reporting requirements and timetables

**Governance, Risk and Compliance**

- Maintain compliance with FCA regulation including third parties
- Unqualified annual audit report
- Satisfactory Depositary reviews (no red/critical issues)
- Maintain Enterprise Risk register and manage business in accordance with risk appetite statement and agreed tolerances

**LCIV 2017/18 KPIs**

- AUM: At or above £6.3 Bn
- Income: Management fee income in line with budget
- Expenses: Expense spend in line with budget
- Clients: Deliver products and services from which all 32 LLA pension funds can benefit and have agreed and signed SLAs in place
- Staff: 13 staff on-boarded
- Governance: No significant audit or compliance issues

**Charging Principles.** As LCIV's purpose is to improve cost efficiency and provide better risk adjusted performance and broader investment opportunities for Local Government Pension Scheme Funds, the company does not aim to make a significant profit. In light of this, LCIV has developed the following charging principles and structure.

**Fairness:** Charges should be structured as fair as possible to ensure benefits and costs are fairly distributed across investors.

**Transparency:** LCIV will be transparent with any charges to the LLAs and provide quarterly budget updates to stakeholders.

**Structure:** LCIV's business model currently has two charging mechanisms:

(i) a management fee on AUM

(ii) an annual service charge of £25,000

LCIV is still in the build phase of development and will require additional funding to invest in required skills, expertise and core infrastructure in order to become a fully established fund management company. To address this funding need, LCIV is proposing to introduce a development funding charge (DFC) to cover the investment required to build the organisation and become self-funded.

**Management Fee:** The key criteria when setting the LCIV management fee level is to ensure that clear, material net benefits can be achieved inclusive of the LCIV management fee. Therefore, LCIV will ensure:

- Management fees in the annual budget and MTFS will be set at prudent levels
- Management fees are transparently included in the TER of each sub-fund; annual service charge costs are not included in the TER

**Service charge:** The £25,000 annual service charge is akin to a membership fee providing access to the breadth of LCIV services. The charge is invoiced at the start of each financial year.

**Development Funding Charge (DFC):** The DFC will cover the investment needed to build out LCIVs fund offering and organisational infrastructure. The DFC level will be set through the annual planning process and proposed to the shareholders when the Annual Budget for each financial year is set. It is proposed that the DFC is invoiced in two parts with 66% of the charge invoiced in April with the remaining 33% to be invoiced in December of each financial year. The December invoice will be adjusted according to the prevailing budget and business needs.

## 5. 2016/17 BUDGET

The status of the annual budget for 2016/17 was reviewed and approved by LCIV Shareholders at the Company General Meeting held on 13th December 2016. The summary figures from the budget include £1.5Mn in revenues, £2.3 Mn operating expense and a deficit of near £800K. The Shareholders agreed that the 2016/17 budget deficit would be covered by existing capital reserves. Details of the 2016/17 budget and capital adequacy statement can be found in Appendix A.

## 6. FUND LAUNCH PLANS AND AUM AND REVENUE FORECAST

**Investment Principles.** LCIV is currently developing a proposal for Investment Principles and will be sharing this with the LLAs to develop a high level set of investment principles which will provide a framework for LCIV's efforts to identify and offer attractive investment opportunities aligned with the LLA's principles and needs.

**Current fund status and revenue.** As of end December 2017, LCIV has launched 6 sub-funds and 14 LLAs are invested with £3.2 Bn AUM. Management fee income in the first half of 2016/17 was £260K and forecast to reach £640K by March 2017. The service charge for the current year is £25K per LLA with total service charge revenue of £850K including a payment from one LLA from 2015/16. Consolidated management fees and service charge revenue for the first year of operation are forecast to be £1.5 Mn.

**Fund launch and AUM forecast.** LCIV will be completing the sub-fund launches of the Commonality, Quality and Conviction (CQC) phase encompassing Equities and Multi-Asset funds in early 2017. The asset class prioritisation of the forward looking fund launch plans has been based on the London LGPS Funds consolidated asset allocation as of March 2015. Given that the asset classes with the largest fund allocations are also (relatively speaking) easier asset classes to access, prioritising fund launches based on the size of existing fund allocation was seen as the optimal route to provide opportunities to as many LLAs as possible in the shortest timeframe. As such LCIV has prioritised the procurement of Global Equities funds to be delivered in 2017, followed by Fixed Income funds and broadening to Real estate, Infrastructure and Alternative assets.

While LCIV builds its in-house capacity particularly in the Real Estate and Infrastructure areas, efforts will also be made to explore options to invest earlier in these asset classes. This will include investigating opportunities to work with other areas of the Local Government Pension Schemes (LGPS).

It is recognised that the current triennial valuation may impact the strategic asset allocation and investment needs of the LLAs. With this in mind, LCIV will liaise closely with the LLAs and the Investment Advisory Committee to ensure that the focus of our fund development and investment opportunities are aligned with their needs.

As we move to broaden the asset classes, LCIV should add value beyond leveraging scale to reduce management fees. With the likely changes in strategic asset allocation, combined with fundamental changes in markets, together with industry upheaval for fund managers, the LLAs, working with LCIV, could move beyond standard products and have products built to their specifications which could have both lower fees and materially better returns. This is most applicable to “alternative” asset classes which are planned for launch at the end of 2018 and during 2019, although structural changes in the Fixed Income markets, particularly in traditional, publicly traded assets, have meant that it may be necessary to look at private market debt as we expand into Fixed Income.

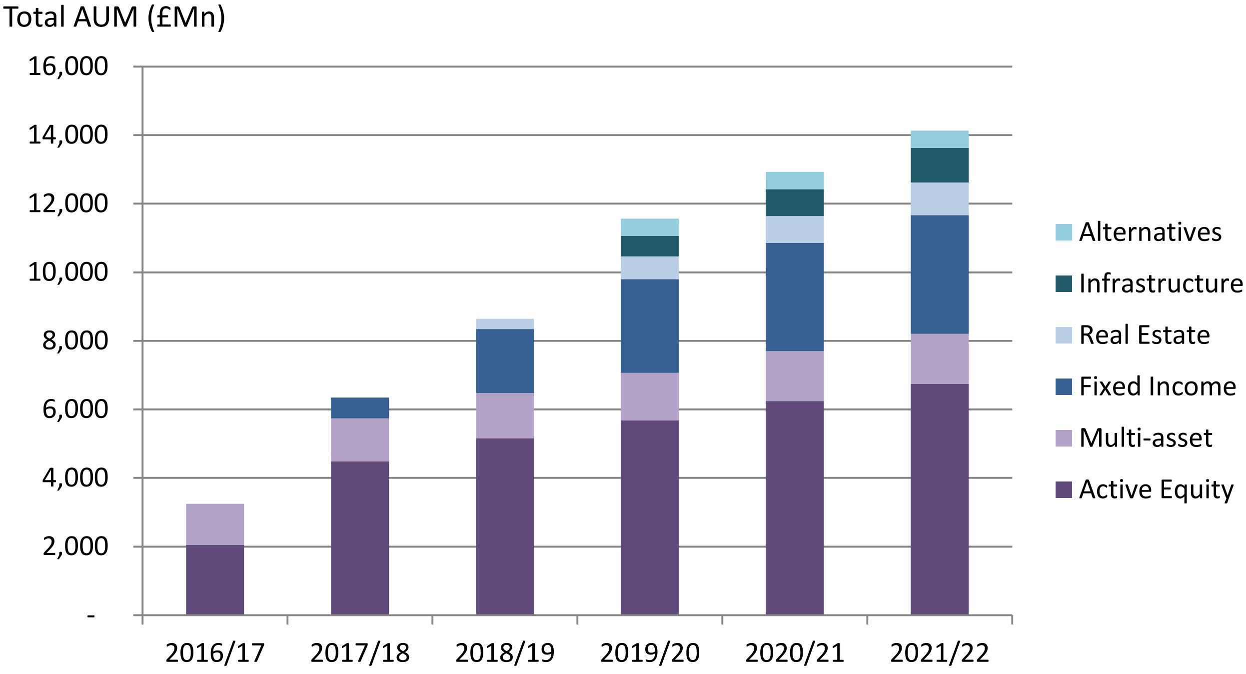
The fund launch and supporting plan is based on the cost structure and operational requirements of a single-manager sub-fund operating under LCIV’s current Financial Conduct Authority (FCA) regulatory approvals which do not include advisory services. The fund plan includes an expansion from 6 to 28 sub-funds over the planning period and growth from £3.2 Bn AUM in March 2017 to £14.1 Bn by March 2022. The fund launch plan for 2016/17 and 2017/21 with estimated AUM at launch date are shown in Fig. 1 below.

**Figure 1. LCIV Fund Launch Plan with estimated AUM at launch**

| | Q1 | | | Q2 | | | Q3 | | | Q4 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | April | May | June | July | August | September | October | November | December | January | February | March | New Funds | Total Funds |
| 2016/17 | | Ballie Gifford Global Alpha (£1455) | Ruffer Abs Return (£335) (Purford Abs Return (£200) | *Work on passive asset structure and fee negotiations* | | | | | Newton Real Return (£330) | | | | 4 | 6 |
| 2017/18 | Majedie (£530) Newton Global Equity (£500) | Longview (£450) | | | | Global Equity 1 (£200) Global Equity 2 (£200) Global Equity 3 (£150) | | | Global Equity 4 (£150) Global Equity 5 (£150) | | | Fixed Income 1 (£300) Fixed Income 2 (£300) | 10 | 16 |
| 2018/19 | | | Real Estate 1 (£300) | Fixed Income 3 (£300) Fixed Income 4 (£300) | | | Fixed Income 5 (£300) Fixed Income 6 (£300) | | | | | | 5 | 21 |
| 2019/20 | | | Real Estate 2 (£300) | Infrastructure 1 (£300) Infrastructure 2 (£300) | | | Fixed Income 7 (£300) Fixed Income 8 (£300) | | | Allternatives 1 (£250) Allternatives 2 (£250) | | | 7 | 28 |
| 2020/21<br>2021/22 | No individual fund launches detailed in plan<br>AuM growth driven by subscriptions to funds on platform | | | | | | | | | | | | | |

The fund launch plan for financial years 2020/21 and 2021/22 does not identify specific fund launches either by asset class or size as this is highly speculative given potential asset allocation changes from the next triennial review in 2019. The forecast AUM growth in the plan beyond the initial fund launch AUM is driven by estimates of additional subscriptions into existing funds across the asset classes. The AUM forecast across asset classes in shown in Fig. 2.

**Figure 2. AUM Forecast based on 2017-2021 Fund Launch Plan**



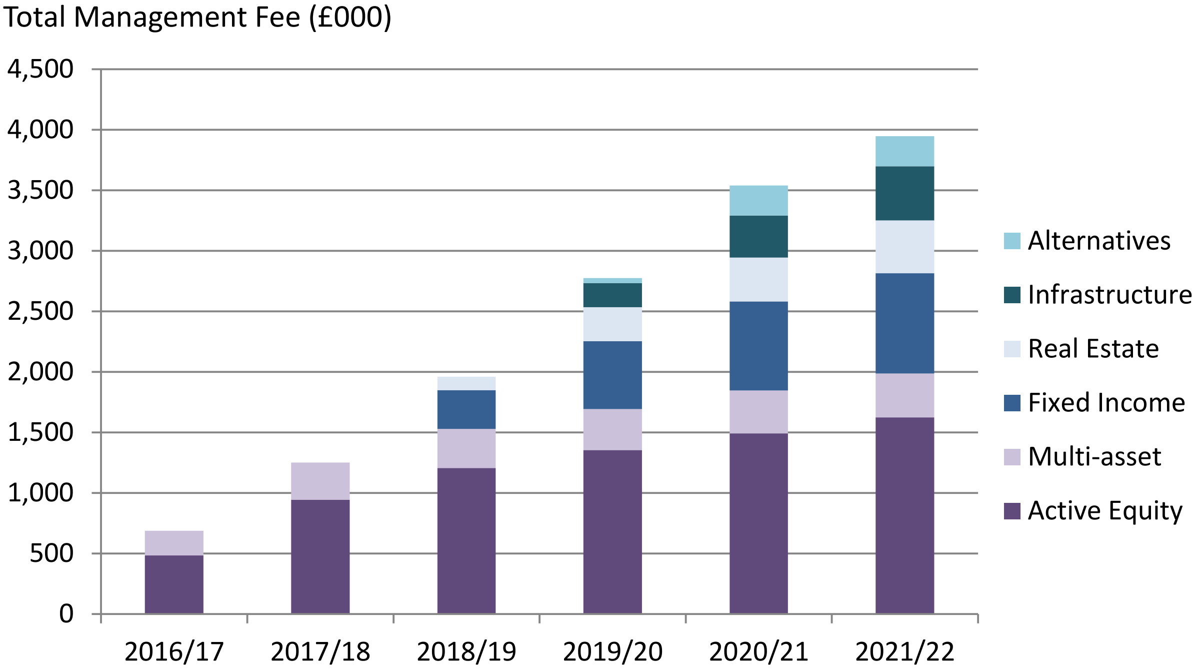

Overall, the forecast AUM of £14.1 billion by March 2022 represents the transfer of 49% of the total £29.2 Bn (as of March 2015) of LLA assets. The forecasted share of LLA asset transfer to LCIV is based on March 2015 LLA asset allocation and outlined below in Fig. 3.

**Figure 3. Share of LLA Assets transferred based on 2017 /21 Fund Launch Plan**

| | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 | FY 2021 |
|---|---|---|---|---|---|---|
| **Share of LLA Assets** | **Mar-17** | **Mar-18** | **Mar-19** | **Mar-20** | **March 21** | **March 22** |
| Active Equities | 21% | 46% | 53% | 59% | 64% | 70% |
| Passive Equities | 0% | 0% | 0% | 0% | 0% | 0% |
| Multi Asset | 45% | 48% | 50% | 52% | 55% | 55% |
| Fixed Income | 0% | 12% | 38% | 55% | 64% | 70% |
| Property | 0% | 0% | 14% | 32% | 38% | 45% |
| Infrastructure | 0% | 0% | 0% | 306% | 398% | 517% |
| Alternative Assets | 0% | 0% | 0% | 36% | 36% | 36% |
| Total share of LLA Assets transferred | 11% | 22% | 30% | 40% | 44% | 49% |

**Revenue forecast.** Based on the fund launch plans and estimated AUM, the management fee revenue is forecast to grow from £640K at end 2016/17 to £3.9 Mn by end March 2022. LCIV is also currently working with stakeholders to agree an approach to passive assets. During 2016/17, LCIV negotiated significant savings for fourteen funds invested with Legal & General and it has been suggested that the LLAs who benefitted from LCIVs time and effort should pay a fee for the realised benefits. This potential fee would be additional income and has not been included in the revenue forecast. The management fee forecast for the planning period is shown in Fig. 4 below.

Figure 4. Management fee Revenue Forecast




The assumptions of the above revenue forecast over the planning period include:

- management fees per asset class are constant over planning period
- management fee for Equities and Fixed Income is 2.5 basis points (bp)
- management fee for Real Estate, Infrastructure and Alternatives is 5.0 bp
- additional subscriptions are made to funds where no capacity constraints apply
- passive funds will be managed outside LCIV and no passive fee revenue is included
- there are no fund redemptions or sub-fund closures during the planning period
- current LCIV regulatory approvals are sufficient to implement plans

There are two key components for LCIV to deliver the above fund launch plans and associated revenue targets. These include:

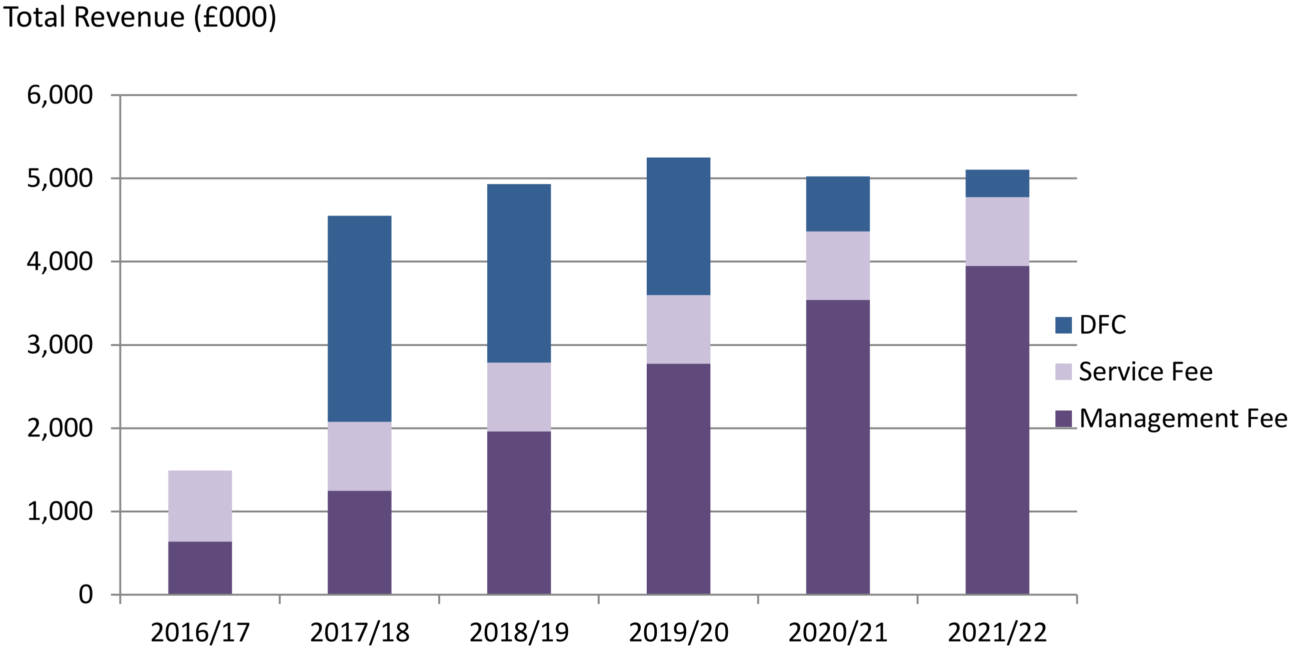
(i) the provision of attractive investment opportunities by LCIV to the LLAs

(ii) the pace at which the LLAs transfer their assets to LCIV

**Service Charge and Development Funding Charge.** The annual service charge for the planning period will be at £25,000. The DFC which is proposed to be introduced in 2017/18 would be set at £75,000 in 2017/18 and decline year on year to £10,000 in 2021/22.

**Total revenue forecast.** Based on the management fee forecast, service charge and proposed DFC, the total revenue is forecast to grow from £1.5 Mn in 2016/17 to £5.1 Mn in 2021/22 enabling the company to invest in the critical resources, skills and infrastructure to deliver the forward looking plans. Total revenue forecast is shown in Fig. 5.

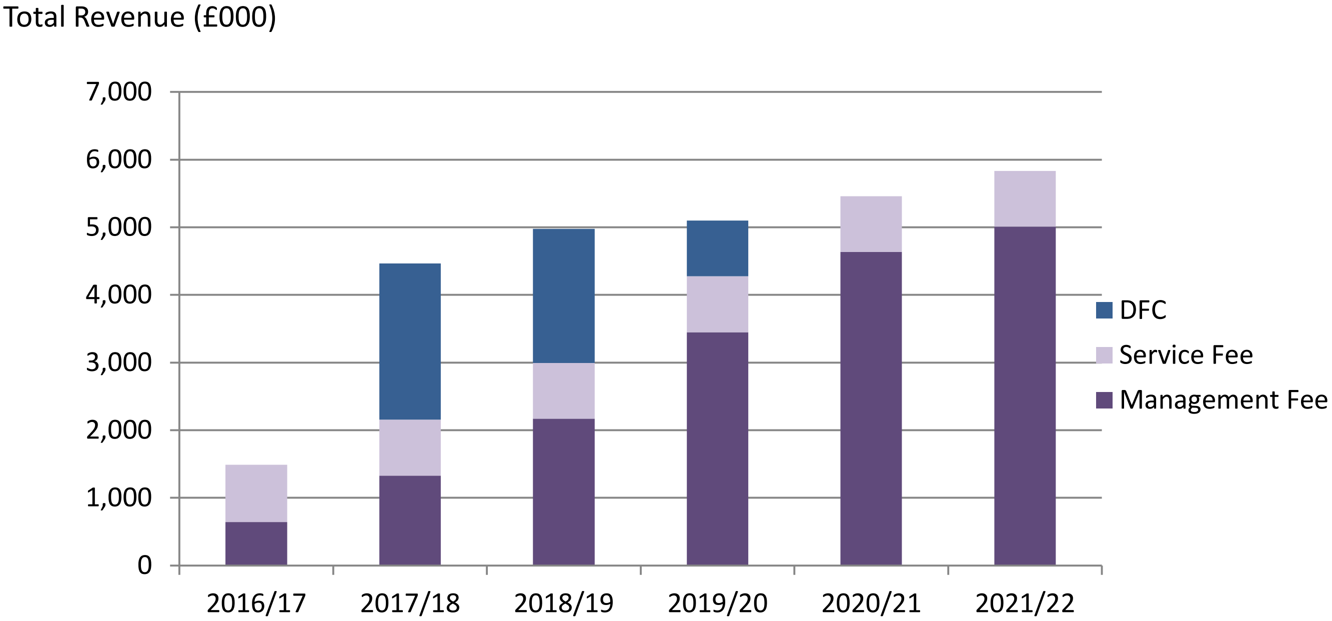
**Figure 5. Total Revenue Forecast**




On 16 December 2016 Marcus Jones MP (Minister for Local Government) wrote to Lord Kerslake (Chair of LCIV) following a meeting to discuss the joint submission of LCIV and the LLAs to government in July 2016. In his letter the Minister noted that, in the government's view, the current forecasts and transition of assets into the LCIV pool will be "unacceptably slow".

Recognising that transition of assets can only happen as and when LCIV provides the necessary investment opportunities and material benefits can be accessed, a more ambitious pace of fund transfer would suggest that AUM of £19.4 Bn could be achieved by March 2022 (versus planned £14.2 Bn) representing 67% of total LLA assets (versus planned 49%). Apart from responding to the government's challenge this would also result in the DFC declining to £25,000 in 2019/20 and enabling LCIV to cover its annual operating costs from fund management fees by 2020/21, two years earlier than forecast in the current plan. This scenario is based on a faster pace of asset transition and assumes no change in the forecast cost, cost structure or number of funds. LCIV will work closely with the LLAs and seek to jointly deliver a more aggressive pace of asset transfer during the planning period. A summary of revenue scenario with increased pace of fund transfer is shown below in Fig.6.

**Figure 6. Revenue Scenario**




## 7. EXPENSE FORECAST

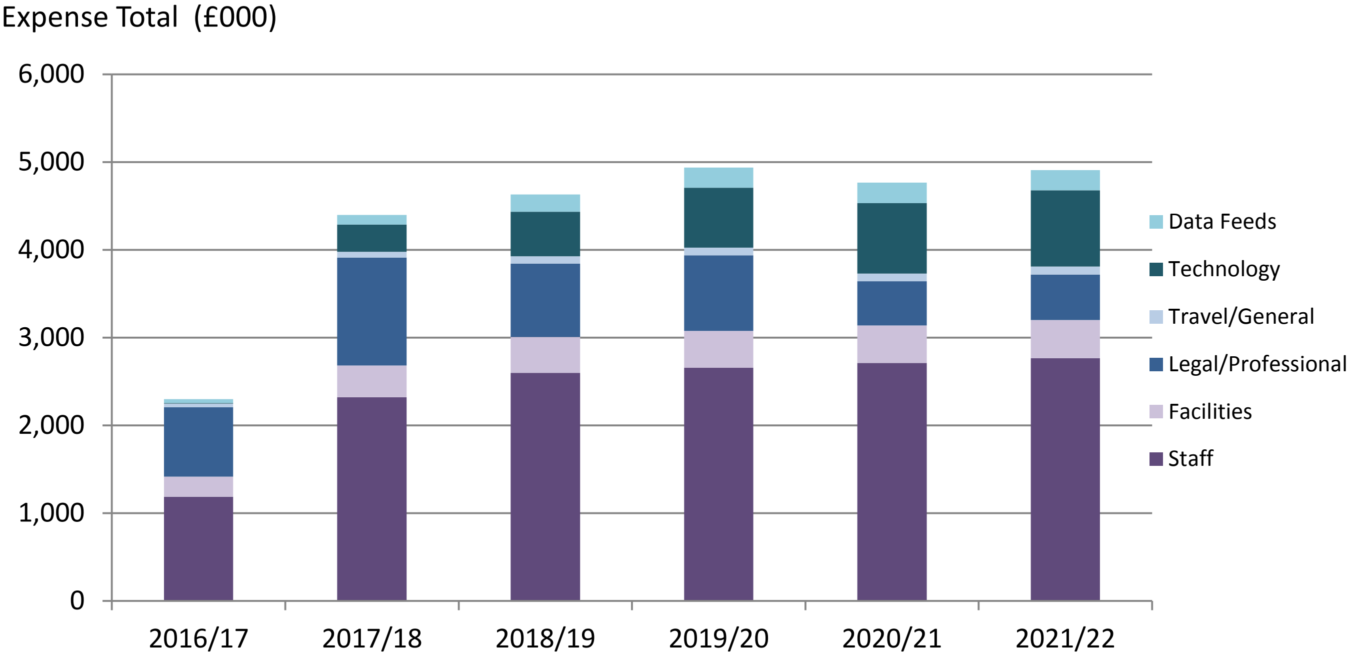
LCIV is moving from implementation and proof of concept to a key development phase for the organisation which requires additional resource investment to deliver proposed fund launch plans. The key cost drivers over the planning period are the variety, complexity and number of sub-funds, staff expansion, investment procurement, professional costs relating to fund structuring and launches, and core information and communication technology (ICT), risk and systems implementation.

From the current base of 6 funds, the number of funds is forecast to increase to 28 and new asset classes may require different fund structures outside of LCIVs Authorised Contractual Scheme (ACS). Staffing to support the growth in assets and business complexity is planned to increase from 11 to 25 resources. There will be a continuing need to utilise external legal and professional services for the fund launches, technology development and organisational expansion.

Consequently, LCIV's costs will increase from £2.3 Mn in March 2017 to £4.9 Mn by March 2022. The increase in costs is primarily driven by operating costs (including the need to recruit staff with the appropriate skills and knowledge base), as well as costs relating to fund launches and operational set up.

To be consistent with the charging principles and ensure costs are fairly distributed across stakeholders, LCIV will be proposing charging fund opening costs such as legal fees and investment consulting fees to the funds, where possible. Accordingly, investors in the fund would incur the directly related fund set-up costs. These costs could be in the region of £50K per sub fund, but can be amortised over a number of years to reduce the immediate impact on early investors. However, for cash flow reasons, the financial plan includes the budgeted set up costs as an LCIV expense currently and would reduce LCIV costs if charged to the sub fund. A summary of the expense forecast is shown below in Fig. 7

**Figure 7. Total Expense Forecast**




The rationale and key assumptions across the cost line items are outlined below:

**Staff.** The staff expansion plans and timing have been driven by three key factors:

- fund launches by asset class (see Fig. 1) and the need to hire front office investment, investment oversight and client support capabilities to deliver and monitor a the planned fund range;
- the need to hire core skills for middle and back office including a fund accounting, risk management, and systems and data management; and
- additional middle and back office staff to support the compliance and operational requirements of the fund expansion.

An overview of the current resources and staff build plans are in Fig. 8 below.

Figure 8. 2017/18 Staff Build Plans

| Year | Quarter | Front Office | Middle/Back Office | New Staff | Total Staff |
|---|---|---|---|---|---|
| *Current Resources* | | *CEO and Office Manager/EA*<br>*CIO*<br>*AD Borough Client Management*<br>*Head of Investment Oversight*<br>*Investment Analyst*<br>*Investment Analyst* | *COO*<br>*Programme Director*<br>*Compliance/Risk Manager*<br>*Operations Manager* | | *11* |
| 2017/18 | Q1 | Global Equities Manager<br>AD Investment Oversight/ Performance<br>Client management Assistant | Fund Accountant<br>Systems/Data Manager | 5 | 16 |
| 2017/18 | Q2 | Fixed Income/ Alternatives Manager | Management Accountant<br>Operations Assistant<br>Project Manager | 4 | 20 |
| 2017/18 | Q3 | Real Estate/ Infrastructure Manager | Risk Officer | 2 | 22 |
| 2017/18 | Q4 | Client Management Assistant<br>Administrative Assistant ---- General Support | | 2 | 24 |
| 2018/19 | Q1 | | Compliance Assistant | 1 | 25 |

The plan envisages front office staff growing from 5 to 11 staff. The hiring plan has been developed to ensure:

- adequate time for asset class managers to be in place prior to the launch of the new asset class funds;
- sufficient client management resources to deliver effective LLA engagement, service and appropriate data and reporting to the LLAs; and
- robust oversight of sub-funds, including rigorous challenge of investment manager performance.

In order to ensure the business is properly supported, compliant with regulatory requirements, and that risks are adequately identified and managed, the resourcing plan includes the middle and back office growing from 4 to 11 staff. The new staff will fill key functional areas including:

- fund and firm accounting
- risk management
- systems and data support
- compliance
- operations.

A general administration assistant will hired to support the administration needs of both the front and back office staff and expansion.

The remuneration of staff has been budgeted using scales and salary bands of London Councils as a guide. In addition, the LCIV Board is committed to following the London Council Diversity and Equality Guidelines and will apply these during the LCIV staff recruitment process.

**Legal and Professional Fees.** LCIV work with a variety of professional advisers who advise and assist on a number of technical issues over the planning period. Eversheds are the main source of legal support and provide advice on fund launches, tax, Freedom of Information (FoI), regulatory compliance, employment and governance matters. Other professional service costs include investment oversight support, audit services with Deloitte, Financial Conduct Authority (FCA) fees, internal audit costs, and investment consultant fees in respect of new fund launches and procurement. There will also be consulting support for IT implementation and staff expansion and hiring.

**Technology and Data Feeds.** ICT support is currently provided by London Councils/City of London as part of the facility arrangements with London Council. As the business requirements of LCIV grow, the technology infrastructure will require additional resources both in terms of staffing and systems to ensure that the appropriate level of resilience and disaster recovery/business continuity support are in place and appropriate to the scale and size of a substantial asset manager. The target operating model will be scoped in Q1 FY 2017 for the systems infrastructure across client and management reporting, performance measurement, online client portals, business continuity and risk management.

As the range and complexity of the ACS platform grows and its fiduciary responsibilities increases, LCIV must ensure that the staff and the Board have the necessary tools to manage this growth and deliver appropriate oversight of the operation. Investment in the infrastructure will allow for operational leverage as the AUM and business expands.

## 8. CAPITAL SPENDING FORECAST

The forecast includes a total capital expenditure of £150K in 2018/2019, comprising £100,000 for ICT equipment which will be depreciated over 3 years and an allowance of £50,000 for fixtures and fittings to support office expansion within London Councils' Southwark Street offices which will also be depreciated over 3 years.

## 9. BENEFITS DELIVERY

LCIV is focused on delivering benefits to the LLAs. Regarding quantifiable benefits for the initial launch phase of funds, these have been calculated based on the fee scales pre and post transition and include the costs associated with the LCIV charges including asset servicer and custody costs.

As of end Q3 2016, the total benefits delivered on £2.5 Bn AUM was estimated to be just under £1m annualised. Incorporating the second half 2016/17 fund launch plan and AUM forecast, the estimated benefits delivered in 2016/17 is forecast to be £1.5 Mn annualised on £3.2 Bn AUM. An additional three sub-funds are forecasted to be launched during Q2 of 2017 with a further £1.5 Bn AUM delivering an estimated £2.4Mn annualised additional savings. In addition, LCIV have negotiated significant savings fee savings for fourteen LLAs invested with Legal & General in passive life funds delivering an annualised savings of £1.85m net on the £3.1 Bn AUM held in LGIM passive life funds outside of LCIV.

With the completion of the CQC in the early FY 2017, the approach to calculating benefits will be reviewed. Where new funds are being launched through a procurement exercise, estimated savings will be provided by comparing the standard institutional rates charged by third party investment manager fees compared to the rates being offered through LCIV.

Tax benefits, procurement savings and lower custody costs are additional cashable benefits with the first procurement benefits being realised with global equity exercise that is currently underway. It is not possible to estimate withholding tax benefits with any accuracy at this point without undertaking a complex and time consuming exercise, however the ACS is a more tax efficient fund structure than many others and was the determining factor in choosing this fund model. Custody costs will be reduced as assets increase through the CIV, but also at a local level, where LLA custody costs should decrease over time as assets are moved across to LCIV.

The non-cashable or softer benefits previously outlined include: data transparency and data access, shared investment manager oversight, regulatory scrutiny, governance, access to alternative investments, responding proactively to the wider LGPS efficiency agenda, market management as well as greater levels of responsible investment and engagement across London.

## 10. FINANCIAL SUMMARY

The key summary financials over the planning period show AUM growth from £3.2 Bn to £14.1 Bn and an increase in related management fee income from £640K to £3.9 Mn. Increased spend on critical staff and systems resources to build out the core investment and operational processes and procedures will result in costs increasing from £2.3 Mn to £4.9 Mn. As previously noted, the increase in costs is due to fund launches, operational set up and normal operating costs with the earlier years of the plan's costs relating to fund launch and set up.

To fund the shortfall during this key development phase, LCIV is proposing a DFC of £75,000 in 2017/18. The DFC will be invoiced in two parts; two thirds of the DFC will be billed in April at the beginning of the financial year and the balance invoiced in December in the financial year to which the DFC relates. The DFC will be set and agreed as part of the annual budgetary process which according to the shareholders' agreement will be agreed no later than 60 days prior to the beginning of the relevant financial period. The DFC will decline over the planning period as management fee income increases and LCIV becomes self-funding from management fee income.

The service charge is forecast to remain constant at £25,000 and will be invoiced annually in April at the beginning of each financial year.

The majority of LCIV's expenses are either monthly (payroll, reporting partner, IT costs, data feeds) or quarterly in arrears such as London Council's (facilities) or City of London's fees. Consulting and other professional fees which are fund or project related are ad hoc in nature but represent less than 15% of annual expenditure.

LCIV is not a capital intensive operation and over the course of the five years of the MTFS, has budgeted for capital expenditure of a total of £150K to cover IT upgrades and office refurbishment in financial years 2017/18. The capital expenditure is required to cover office expansion due to the increase in headcount and increased IT infrastructure resilience. Therefore, the balance sheet of LCIV is operationally liquid and meets the requirement for FCA capital adequacy purposes and LCIV does not anticipate cash flow management challenges provided the annual service charge and DFC are paid as invoiced.

If any significant surplus occurs during the planning period, LCIV's Board will propose one of three options to the LLAs, those being:

(i) retain surplus and increase capital within the business,

(ii) reduce DFC, annual service charge and/or ad valorem charge in subsequent years

(iii) pay out surplus to shareholders as a dividend

The 2017/2021 Profit and Loss, Balance Sheet and Cash Flow summary statements are shown the Summary Financial Statements below in Fig. 9.

Figure 9. Summary Financial Statements

| KEY SUMMARY DATA | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 | FY 2021 |
|---|---|---|---|---|---|---|
| | March 17 | March 18 | March 19 | March 20 | March 21 | March 22 |
| Assets under management (AUM) in £Mn | 3,252 | 6,344 | 8,641 | 11,562 | 12,922 | 14,129 |
| New Sub-funds launched in year | 4 | 10 | 5 | 7 | 0 | 0 |
| Total Sub Funds FY Year End | 6 | 16 | 21 | 28 | 28 | 28 |
| LCIV Staff (FY Year End) | 11 | 24 | 25 | 25 | 25 | 25 |
| LCIV Shareholders/Investors | 32 | 32 | 32 | 32 | 32 | 32 |
| Annual Service Charge | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| Development Funding Charge (DFC) | | 75,000 | 65,000 | 50,000 | 20,000 | 10,000 |

| 2027/2021 PROFIT AND LOSS | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 | FY 2021 |
|---|---|---|---|---|---|---|
| | March 17 | March 18 | March 19 | March 20 | March 21 | March 22 |
| **Operating Income** | | | | | | |
| Service Charge | 850,000 | 800,000 | 800,000 | 800,000 | 800,000 | 800,000 |
| Development Funding Charge (DFC) | | 2,400,000 | 2,080,000 | 1,600,000 | 640,000 | 320,000 |
| Management Fee by Asset Class | | | | | | |
| *Active Equity* | *426,990* | *944,306* | *1,206,540* | *1,355,253* | *1,490,778* | *1,624,238* |
| *Passive Equity* | *0* | *0* | *0* | *0* | *0* | *0* |
| *Multi-Asset* | *212,593* | *306,270* | *321,584* | *337,663* | *354,546* | *363,193* |
| *Fixed Income* | *0* | *0* | *320,000* | *562,375* | *736,106* | *826,836* |
| *Alternatives* | *0* | *0* | *112,500* | *519,167* | *958,000* | *1,134,100* |
| Total Management Fee by Asset Class | 639,583 | 1,250,576 | 1,960,623 | 2,774,457 | 3,539,430 | 3,948,367 |
| | | | | | | |
| Total Operating Income | 1,489,583 | 4,450,576 | 4,840,623 | 5,174,457 | 4,979,430 | 5,068,367 |
| | | | | | | |
| **Expenses** | | | | | | |
| Staff | 1,185,744 | 2,318,220 | 2,596,558 | 2,657,295 | 2,710,441 | 2,764,650 |
| Facilities | 231,651 | 359,256 | 409,082 | 419,560 | 427,751 | 436,106 |
| Legal and Professional | 791,046 | 1,231,000 | 836,000 | 859,000 | 504,000 | 519,000 |
| Travel and General Expenses | 38,465 | 67,375 | 82,750 | 89,000 | 89,250 | 89,240 |
| Technology | 6,944 | 308,458 | 510,167 | 682,240 | 803,500 | 869,500 |
| Data feeds | 43,880 | 110,000 | 195,000 | 230,000 | 230,000 | 230,000 |
| Total Operating Expenses | 2,297,731 | 4,394,309 | 4,629,557 | 4,937,095 | 4,764,942 | 4,908,496 |
| | | | | | | |
| **EBITDA** | -808,148 | 56,267 | 211,066 | 237,362 | 214,488 | 159,871 |
| | | | | | | |
| Depreciation | 1,333 | 1,842 | 51,719 | 50,509 | 50,000 | 0 |
| Interest Income | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 | 15,000 |
| **PBT** | -794,482 | 69,425 | 174,347 | 201,853 | 179,488 | 174,871 |
| | | | | | | |
| Corporate Tax @15% | 0 | 0 | 0 | 0 | 0 | 825 |
| **Net Profit/Loss** | -794,482 | 69,425 | 174,347 | 201,853 | 179,488 | 174,046 |
| | *-794,482* | *-725,056* | *-550,710* | *-348,856* | *-169,368* | *0* |

Figure 9. **Summary Financial Statements (continued)**

| 2017/2021 BALANCE SHEET | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 | FY 2021 |
|---|---|---|---|---|---|---|
| **BALANCE SHEEET** | March 17 | March 18 | March 19 | March 20 | March 21 | March 22 |
| **Non-Current Assets** | | | | | | |
| Plant, Property and Equipment (PPE) | 5525 | 5525 | 155525 | 155525 | 155525 | 155525 |
| Accumulated Deprecation | 1,456 | 3,297 | 55,017 | 105,525 | 155,525 | 155,525 |
| Total Non-Current Assets | 4,070 | 2,228 | 100,509 | 50,000 | 0 | 0 |
| | | | | | | |
| **Current Assets** | | | | | | |
| Cash | 4,068,591 | 4,139,858 | 4,215,924 | 4,468,286 | 4,697,774 | 4,871,819 |
| Total Current Assets | 4,068,591 | 4,139,858 | 4,215,924 | 4,468,286 | 4,697,774 | 4,871,819 |
| | | | | | | |
| Total Assets | 4,072,660 | 4,142,086 | 4,316,432 | 4,518,286 | 4,697,774 | 4,871,819 |
| | | | | | | |
| **Capital and Reserves** | | | | | | |
| A Class Shares | 32 | 32 | 32 | 32 | 32 | 32 |
| B Class Shares | 4,800,000 | 4,800,000 | 4,800,000 | 4,800,000 | 4,800,000 | 4,800,000 |
| Retained Earnings | 67,110 | -727,372 | -657,946 | -483,600 | -281,746 | -102,258 |
| Profit/Loss in year | -794,482 | 69,425 | 174,347 | 201,853 | 179,488 | 174,046 |
| Total Capital and Reserves | 4,072,660 | 4,142,086 | 4,316,432 | 4,518,286 | 4,697,774 | 4,871,819 |
| | | | | | | |
| Total Liability and Shareholder Capital | 4,072,660 | 4,142,086 | 4,316,432 | 4,518,286 | 4,697,774 | 4,871,819 |

| 2017/2021 CASHFLOW | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 | FY 2021 |
|---|---|---|---|---|---|---|
| | March 17 | March 18 | March 19 | March 20 | March 21 | March 22 |
| **Operating Activites** | | | | | | |
| Operating Profit/Loss | -794,482 | 69,425 | 174,347 | 201,853 | 179,488 | 174,046 |
| Depreciation | 1,333 | 1,842 | 51,719 | 50,509 | 50,000 | 0 |
| Change in Working Capital | 0 | 0 | -150,000 | 0 | 0 | 0 |
| Cash from operating activities | -793,148 | 71,267 | 76,066 | 252,362 | 229,488 | 174,046 |
| | | | | | | |
| Total change in cash | -793,148 | 71,267 | 76,066 | 252,362 | 229,488 | 174,046 |
| Beginning cash balance | 4,865,809 | 4,068,591 | 4,139,858 | 4,215,924 | 4,468,286 | 4,697,774 |
| Ending cash balance | 4,068,591 | 4,139,858 | 4,215,924 | 4,468,286 | 4,697,774 | 4,871,819 |

## 11. REGULATORY CAPITAL REQUIREMENT

The regulatory capital requirement is determined by a FCA formula derived from a combination of AUM and the expenses of the business. As a regulated entity, LCIV is required to maintain a minimum of regulatory capital at all times and must formally report this to the FCA on a quarterly basis.

LCIV was capitalised to cover a budgeted AUM of £25 Bn with the issuance of £4,950,000 of B shares at £1 each. The capitalisation changed during the 2016/17 financial year due the planned merger of Richmond and Wandsworth Pension Funds resulting in a current capitalisation is £4,800,000. LCIV will be able to meet its regulatory requirements based on the current capital position and the proposed financial plan. A summary of the capital adequacy requirements and surplus are below in Fig. 10.

**Figure 10. 2017/21 Capital Requirement**

| CAPITAL ADEQUACY | FY 2016 March 17 | FY 2017 March 18 | FY 2018 March 19 | FY 2019 March 20 | FY 2020 March 21 | FY 2021 March 22 |
|---|---|---|---|---|---|---|
| AUM Assumptions 2017/2021 (£ Mn) | 3,252 | 6,344 | 8,641 | 11,562 | 12,922 | 14,129 |
| | | | | | | |
| A = Initial Capital - Euro 125k | 111,607 | 111,607 | 111,607 | 111,607 | 111,607 | 111,607 |
| B = 0.02% of AUM in Excess of EUR 250 Mn | 605,797 | 1,224,239 | 1,683,472 | 2,267,707 | 2,539,696 | 2,781,126 |
| C = Quarter of Operating Expenses | 574,433 | 1,098,577 | 1,157,389 | 1,234,274 | 1,191,236 | 1,227,124 |
| D = Professional Negligence | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| | | | | | | |
| Regulatory Capital Requirement [1] | 742,404 | 1,360,846 | 1,820,079 | 2,404,314 | 2,676,303 | 2,917,733 |
| | | | | | | |
| Share Capital | 4,800,032 | 4,800,032 | 4,800,032 | 4,800,032 | 4,800,032 | 4,800,032 |
| Retained Earnings | 67,110 | -727,372 | -657,946 | -483,600 | -281,746 | -102,258 |
| Current Year P&L | -794,482 | 69,425 | 174,347 | 201,853 | 179,488 | 174,046 |
| Total Reserves Carried Forward | 4,072,660 | 4,142,086 | 4,316,432 | 4,518,286 | 4,697,774 | 4,871,819 |
| | | | | | | |
| Surplus/Deficit Regulatory Capital | 3,330,256 | 2,781,239 | 2,496,353 | 2,113,972 | 2,021,471 | 1,954,086 |

## 12. COMMUNICATIONS

The London CIV objective in communicating to stakeholders is to provide transparent and effective communications and to seek ways to deliver ongoing improvements in our communications and reporting processes. LCIV has a wide range of stakeholders with whom it undertakes communications including (but not limited to):

- London local authorities as investors and shareholders
- Wider local government universe
- Central Government
- Investment Managers
- Third Party suppliers
- Media

In particular, the focus with investors and shareholders is to have a regular and consistent communication program to support partnership and two-way dialogue.

LCIV will use a diverse range of channels to communicate with stakeholders including electronic, paper based, verbal, seminars, and surveys. LCIV is committed to providing high quality reporting to its investors, with quarterly reports on performance of its funds, annual and half yearly report and accounts and regular newsletter updates. LCIV will set out its communications strategy and consult with key stakeholders on its content and timing.

## 13. GOVERNANCE

LCIV governance structure includes the Board and a number of committees of the Board, and stakeholder committees including the London Councils' Pensions CIV Sectoral Joint Committee and the Society of London Treasurers led Investment Advisory Committee. These bodies are responsible for providing:

i. Oversight and scrutiny of LCIV;

ii. Providing input, assistance and advice to the development of LCIV's investment product.

A summary of the current governance bodies and their responsibilities are outlined below.

It should be noted that LCIV has engaged with key stakeholders and will be commissioning a governance review to ensure that the governance structures which were set up at the formation of LCIV pool arrangements remain fit for purpose and provide the appropriate levels of communication, governance, planning and decision making.

**Regulated Entity Governance**

**LCIV Board of Directors.** The LCIV Board comprises four non-executive directors (one of whom is the Chair) and three executive directors (the CEO, COO and CIO). The Board is responsible for overseeing the company's strategic direction including, setting and monitoring the delivery of the business plan and objectives, managing business risk including investment and operational risk, and approving fund launches and investment manager selection oversight.

The Board has the authority to delegate certain matters to Committees; however, the Board retains ultimate responsibility and supervises the discharge of all delegated matters. The Board meets at least four times a year on a quarterly basis. The Boards activities are governed by both the Articles of Association of the Company and the Shareholders' Agreement.

**Investment Oversight Committee (IOC).** The IOC is a Board Committee with responsibility for overseeing, maintaining and monitoring the investment strategy, performance and investment risk of the sub funds. The IOC does this in accordance with the investment policies approved by the Board and the investment guidelines, as set out in the Prospectus and any supporting documentation including the investment mandates and in compliance with the requirements of the AIFM Directive. Membership of the IOC consists of two Non-Executive Directors, one of which is the Chairman, and the Chief Executive Officer. The committee meets four times a year.

**Compliance, Audit and Risk Committee (CARCO).** The CARCO is a Board Committee and is responsible for overseeing the compliance and risk obligations of the Company in its capacity as a FCA regulated entity and as an Operator of the London LGPS CIV Authorised Contractual Scheme, including regulatory requirements, market practice and compliance with the requirements of the AIFM Directive. Membership consists of two Non-Executives one of which has risk oversight experience who is also the Chair, and the Chief Executive Officer. The CARCO meets four times a year.

**Remuneration Committee (REMCO).** The REMCO is responsible for setting the principles and parameters of the remuneration policy for the company and to make recommendations to the Board. Appointments to the Committee are made by the Board in consultation with the Chair of the London Council's Pensions Sectoral Joint Committee (PSJC). Appointments are for a period of up to three years extendable by no more than two additional three-year periods. Membership of the REMCO consists of two non-executive directors and the Chair and Vice-chairs of the PSJC. The committee meets at least once a year and otherwise as required.

**Stakeholder Engagement and Governance**

**London Councils' Pensions CIV Sectoral Joint Committee (PSJC).** The PSJC acts as a representative body for those LLAs that have chosen to take a shareholding in London CIV. It exercises functions of the participating LLAs involving the exercise of sections 1 and 4 of the Localism Act 2011 where that relates to the actions of the participating LLAs as shareholders of the company. It also acts as a forum for the participating authorities to consider and provide guidance on the direction and performance of the CIV and, in particular, to receive and consider reports and information from the ACS Operator, particularly performance information, and to provide comment and guidance in response (in so far as required and permitted by Companies Act 2006 requirements and FCA regulations).

**Investment Advisory Committee (IAC).** The IAC is responsible for supporting elected members of the Pensions Sectoral Joint Committee on the investments of the CIV and to liaise with LCIV in defining the investment needs, reviewing fund managers and shaping the annual investment plan. Members consist of pension fund officers and treasurers on a rotating basis for up to three years. The IAC meets on a quarterly basis.

## 14. RISKS TO THE DELIVERY OF THE PLAN

A number of key assumptions have been made in respect of the fund launch schedule, value of asset transfer, AUM level and staffing requirements and costs.

The performance to plan will be reported on a quarterly basis to the Board and LLA stakeholders. As part of the quarterly reporting, the Executive team will provide an update on progress against the business plan's objectives for 2017/8, including fund launches, financial performance and forecast for the remainder of the financial year. The LCIV Enterprise Risk Register summarising the risks, mitigation plans and key risk indicators (KRIs) is shown below in Fig. 11.

Figure 11. LCIV Enterprise Risks

| REF | RISK | MITIGATION | KEY RISK INDICATORS |
|---|---|---|---|
| **1.0** | **INVESTMENT AND INVESTMENT OVERSIGHT** | | |
| **1.1** | Investment offerings do not meet LLAs' investment needs; LLAs do not transfer assets | • Track individual LLA engagement, investment barriers<br>• Ensure early LLA engagement in procurement process and identification of seed investors<br>• Set clear and agreed investment principles | • RAG status of LLA engagement by fund offering<br>• Variance on target quarterly / annual AUM |
| **1.2** | Investments do not deliver required performance | • Complete effective and thorough investment manager due diligence<br>• Monitor fund performance and challenge investment managers | • Quarterly fund performance reporting<br>• Investment managers reviews |
| **1.3** | Fund launches delayed and LLA investments/asset transitions delayed | • Establish disciplined programme management and tracking of milestones<br>• Escalation of issues to Exco which may delay fund launch (eg LLA decisions, benefits business case, 3rd party timelines, etc) | • Launch project milestone delays<br>• Number of items escalated to Exco |
| **1.4** | LCIVs success results in fee reductions by current LLA fund managers and LLAs do not transfer assets | • Effectively leverage scale to negotiate material fee reductions<br>• Close and ongoing engagement with LLAs to ensure strategic alignment with LCIVs purpose | • Level and transparency of communications with fund managers |
| **1.5** | Government views pace of LLA asset transfer as unacceptably slow creating a damaging response to LLAs/ LCIV | • Ensure clear articulation of benefits to be gained by moving to LCIV<br>• Continue to build trust and confidence of LLAs in LCIVs capabilities to deliver benefits and performance | • RAG status of LLA engagement<br>• Variance on target quarterly / annual AUM<br>• Clarity of benefits in business case |
| **2.0** | **CLIENT SERVICE** | | |
| **2.1** | Failure to deliver defined benefits to the London Local Authorities | • Establish ongoing and transparent engagement with LLAs during fund development process in order to build business case and identify benefits<br>• Establish and agree standard benefits calculation approach with LLAs | • Fund business case not clearly articulated<br>• Variance on target and actual benefits |
| **2.2** | Failure to deliver effective client service and reporting | • Establish and implement client service and reporting model<br>• Develop and complete SLA and implement with each LLA | • SLA breaches<br>• Dissatisfied clients |

**Figure 11. LCIV Enterprise Risks (continued**

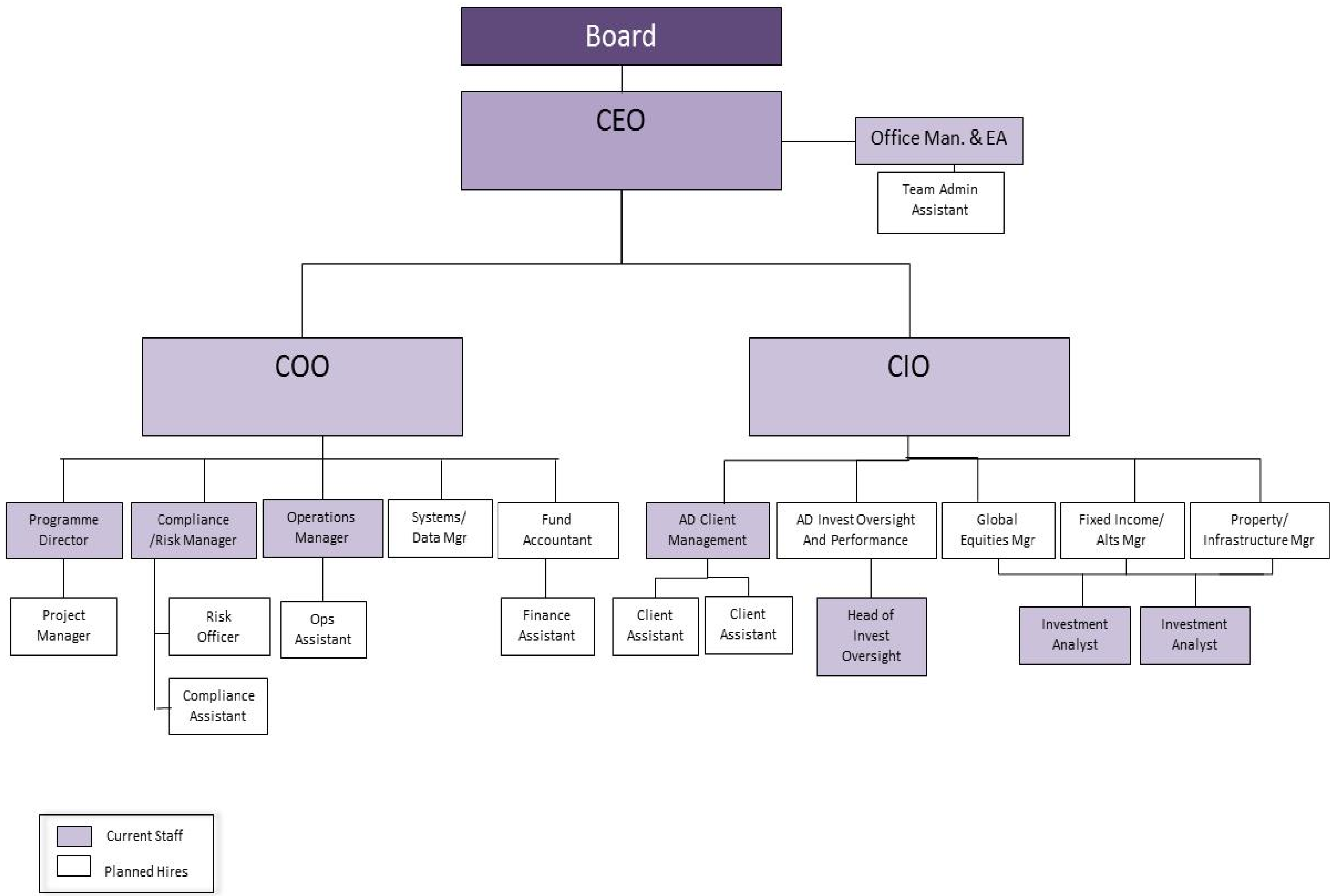
| REF | RISK | MITIGATION | KEY RISK INDICATORS |
|---|---|---|---|
| **3.0** | **FINANCE AND BUSINESS OPERATIONS** | | |
| **3.1** | Insufficient staff, skills and business processes to deliver against business objectives | • Deliver staffing and recruitment plan<br>• Maintain appropriate organisational structure<br>• Ensure staff performance objectives/ targets are documented and tracked<br>• Implement target operating model and document business processes | • Hiring plans not in place<br>• Critical skill/functional gaps<br>• Performance targets not met<br>• Effective business processes not in place |
| **3.2** | Financial controls not in place to ensure delivery against budget | • Monthly budget reporting to ExCo<br>• Quarterly budget reporting to Board and Stakeholders | • Budget variance in monthly and/or quarterly reporting |
| **4.0** | **GOVERNANCE, RISK AND COMPLIANCE** | | |
| **4.1** | Lack of appropriate business governance to deliver against business plan and objectives | • Ensure proper governance is followed for decision making<br>• Deliver accurate, timely and comprehensive MI on KPIs and business plan progress | • Inadequate/misleading MI for decision making<br>• Individual decisions made without oversight which impact the budget, business priorities |
| **4.2** | Lack of appropriate culture and tone from the top to establish high performing team and compliant behaviour | • Ensure organisation has clear vision and purpose<br>• Establish clear roles/responsibilities, performance objectives and targets<br>• Ensure adherence to LCIV policies and procedures | • Employee engagement<br>• Underperformance (organisational/individual)<br>• Compliance breaches |
| **4.3** | Failure to comply with existing or new financial regulations | • Implement thematic based review of controls<br>• Deliver compliance monitoring plan<br>• Complete consistent monitoring and reacting to new regulation | • Items highlighted in compliance monitoring<br>• Volume of new regulation<br>• Items highlighted in external reviews |

# APPENDIX I
# 2016/2017 BUDGET AND CAPITAL ADEQUACY

| 2016/17 SUMMARY BUDGET | |
|---|---|
| | **March 17** |
| **Operating Income** | |
| Service Charge | 850,000 |
| Development Funding Charge (DFC) | |
| Management Fee by Asset Class | |
| *Active Equity* | *426,990* |
| *Passive Equity* | *0* |
| *Multi-Asset* | *212,593* |
| *Fixed Income* | *0* |
| *Alternatives* | *0* |
| Total Management Fee by Asset Class | 639,583 |
| | |
| Total Operating Income | 1,489,583 |
| | |
| **Expenses** | |
| Staff | 1,185,744 |
| Facilities | 231,651 |
| Legal and Professional | 791,046 |
| Travel and General Expenses | 38,465 |
| Technology | 6,944 |
| Data feeds | 43,880 |
| Total Operating Expenses | 2,297,731 |
| | |
| **EBITDA** | -808,148 |
| | |
| Depreciation | 1,333 |
| Interest Income | 15,000 |
| **PBT** | -794,482 |
| | |
| Corporate Tax @15% | 0 |
| **Net Profit/Loss** | -794,482 |
| | *-794,482* |

| 2016/17 CAPITAL ADEQUACY | |
|---|---|
| | **March 17** |
| AUM Assumptions March (£ Mn) | 3,252 |
| | |
| A = Initial Capital - Euro 125k | 111,607 |
| B = 0.02% of AUM in Excess of EUR 250 Mn | 605,797 |
| C = Quarter of Operating Expenses | 574,433 |
| D = Professional Negligence | 25,000 |
| | |
| Regulatory Capital Requirement | 742,404 |
| | |
| Share Capital | 4,800,032 |
| Retained Earnings | 67,110 |
| Current Year P&L | -794,482 |
| Total Reserves Carried Forward | 4,072,660 |
| | |
| Surplus/Deficit Regulatory Capital | 3,330,256 |

# APPENDIX II
## LCIV ORGANISATION CHART



# Pensions CIV Sectoral Joint Committee Item no: 5

## London CIV 2016/17 Financial Report



| | | | |
|---|---|---|---|
| **Report by:** | Brian Lee | **Job title:** | Chief Operating Officer |
| **Date:** | 8 February 2017 | | |
| **Telephone:** | 020 7934 9818 | **Email:** | brian.lee@londonciv.gov.uk |





**Summary:** This report sets out the financial position of the London CIV for the nine months to 31st December 2016, an updated forecast for the year to March 2017 and a capital adequacy statement as of 31st December 2016 as reported to the FCA.



**Recommendations:** The committee is recommended to note:

i. the financial report for the nine months to December 2016

ii. the updated forecast to March 2017

iii. the capital adequacy position of LCIV as at December 2016

# London CIV 2016/17 Financial Report

## Summary

1. This report sets out the financial position of the London CIV for the nine months to 31st December 2016, an up dated forecast for the year to March 2017 a nd a c apital adequacy statement as of 31st December 2016 as reported to the FCA.

2. As previously noted in the draft Medium Term Financial Strategy (‘MTFS’) which was circulated to the Committee in December, the London CIV is forecast to generate an operating loss of £800k.

3. As of the date of this report, the financial forecast for year ending March 2017 for the London CIV remains unchanged.

4. During 3Q, the operating loss was slightly lower than the MTFS forecast but this is largely due to timing differences on the expensing of certain costs which will reverse in the 4Q.

| PROFIT AND LOSS | 3Q YTD | Forecast per MTFS for 3Q | Variance | | Updated Full Year Forecast as of Jan 2017 | Full year Forecast per MTFS | Variance |
|---|---|---|---|---|---|---|---|
| **Operating Income** | **£k** | **£k** | **£k** | | **£k** | **£k** | **£k** |
| Service Charge | 644 | 644 | 0 | | 850 | 850 | 0 |
| Management Fee | 439 | 434 | 6 | | 645 | 640 | 6 |
| | | | | | | | |
| Total Operating Income | 1,083 | 1,077 | 6 | | 1,495 | 1,490 | 6 |
| | | | | | | | |
| **Expenses** | | | | | | | |
| Staff | 894 | 884 | -10 | | 1,196 | 1,186 | -11 |
| Facilities | 165 | 152 | -14 | | 227 | 232 | 4 |
| Legal and Professional | 568 | 609 | 41 | | 793 | 791 | -2 |
| Travel and General Expenses | 19 | 17 | -2 | | 34 | 38 | 4 |
| Technology | 5 | 7 | 2 | | 8 | 7 | -1 |
| Data feeds | 27 | 25 | -2 | | 46 | 44 | -2 |
| Total Operating Expenses | 1,678 | 1,693 | 15 | | 2,305 | 2,298 | -7 |
| | | | | | | | |
| **EBITDA** | -595 | -616 | 21 | | -810 | -808 | -2 |
| | | | | | | | |
| Depreciation | 1 | 1 | 0 | | 2 | 1 | -0 |
| Interest Income | 12 | 10 | 2 | | 13 | 15 | -2 |
| **PBT** | -584 | -607 | 23 | | -798 | -794 | -3 |

## Income

5. The sixth sub fund of the ACS platform, investing in the Newton Real Return Fund (£326m), was launched in the quarter, with assets under management increasing to £3.3bn. Subscriptions totalling nearly £353m were also made in the quarter by a number of LLAs, Camden £205m, Enfield £41m, Hillingdon £5m, Redbridge £102m.

6. No further fund launches are forecast for the fourth quarter, but a number (Majedie, Newton and Longview) are in progress and due to launch in 1Q 2017.

7. It should be noted that the CIV is proposing a fee charging model in respect of the passive funds managed by LGIM to take effect from April 2017, but no income has been accrued in the current financial year.

8. Fund sizes as at 31 December are as follows:

| | |
|---|---|
| **LGPS CIV Global Equity Alpha fund** | £625m |
| **LGPS CIV Diversified Growth Fund** | £346m |
| **LGPS CIV Global Alpha Growth** | £1,489m |
| **LGPS CIV Pyrford Global Total Return Fund** | £201m |
| **LGPS CIV Ruffer Absolute Return Fund** | £347m |
| **LGPS CIV Newton Real Return Fund** | £326m |
| | **£3,335m** |

9. The profile of the AUM growth and other key statistics for the five years to March 2022 are given in the table below:

| | FY 2016/17 Updated Forecast | FY 2016/17 March 17 | FY 2017 March 18 | FY 2018 March 19 | FY 2019 March 20 | FY 2020 March 21 | FY 2021 March 22 |
|---|---|---|---|---|---|---|---|
| Assets under management (AUM) in £Mn | 3,336 | 3,252 | 6,344 | 8,641 | 11,562 | 12,922 | 14,129 |
| New Sub-funds per year | 4 | 4 | 9 | 5 | 7 | 0 | 0 |
| Total Sub funds | 6 | 6 | 15 | 20 | 27 | 27 | 27 |
| LCIV Staff (FY Year End) | 11 | 11 | 24 | 25 | 25 | 25 | 25 |
| LCIV Shareholders | 33 | 32 | 32 | 32 | 32 | 32 | 32 |
| Annual Service Charge | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| Development Funding Charge (DFC) | | | 75,000 | 65,000 | 50,000 | 20,000 | 10,000 |

**Expenditure**

10. As mentioned above, the updated expenditure forecast for the full year is not expected to be materially different from the MTFS.

11. Professional fees for the full year forecast (£793k) include £120k of consulting fees from Mercer and Redington. There has been discussion at the Board and amongst stakeholders as to whether these costs, together with other directly associated third party professional costs such as legal fees, should be charged to the funds – for the purposes of financial prudence these costs have been expensed in the current financial year.

12. The contract with Capita who provided assistance with the LCIV's investment and operational processes and technical support expired at the end of November. A number of these functions have been brought in-house although certain activities continue to be outsourced until the LCIV has the necessary resourcing and systems. The current arrangement will generate a saving in excess of £100k in the next financial year.

13. A detailed breakdown of professional fees for the full year will be presented at the next meeting of the PSJC.

**Balance Sheet and Capital Adequacy**

14. The balance sheet for LCIV as at the end of December 2016 and the forecast balance sheet is detailed below:

| BALANCE SHEEET | December 16 | March 17 |
|---|---|---|
| **Non-Current Assets** | | |
| PPE | 6 | 6 |
| Accumulated Deprecation | 1 | 1 |
| Total Non-Current Assets | 5 | 4 |
| | | |
| **Current Assets** | | |
| Other Assets | 178 | |
| Cash | 4,928 | 4,068 |
| Total Current Assets | 5,107 | 4,068 |
| | | |
| **Current Liabilities** | 679 | |
| | | |
| Total Assets | 4,433 | 4,073 |
| | | |
| **Capital and Reserves** | | |
| A Class Shares | 0 | 0 |
| B Class Shares | 4,950 | 4,800 |
| Retained Earnings | 67 | 67 |
| Profit/Loss in year | -584 | -794 |
| Total Capital and Reserves | 4,433 | 4,073 |
| | | |
| Total Liability and Shareholder Capital | 4,433 | 4,073 |

15. LCIV is required to file regulatory returns to the FCA on a quarterly basis. The calculation of the capital adequacy position at the end of December is detailed below:-

16. The reduction in regulatory capital surplus between December 2016 and March 2017 follows the pending merger of the Wandsworth and Richmond shareholdings which is likely to reduce the share capital by £150k.

17. The Committee is asked to note that the LCIV has a large regulatory capital surplus.

| CAPITAL ADEQUACY | December 2016 | March 17 |
|---|---|---|
| AUM Assumptions 2017 / 2020 (£ Mn) | 3,336 | 3,252 |
| | | |
| A = Initial Capital - Euro 125k | 112 | 112 |
| B = 0.02% of AUM in Excess of EUR 250 Mn | 623 | 606 |
| C = Quarter of Operating Expenses | 576 | 574 |
| D = Professional Negligence | 25 | 25 |
| | | |
| Regulatory Capital Requirement | 759 | 742 |
| | | |
| Share Capital | 4,950 | 4,800 |
| Retained Earnings | 67 | 67 |
| Current Year P&L | -795 | -794 |
| Total Reserves Carried Forward | 4,222 | 4,073 |
| | | |
| Surplus/Deficit Regulatory Capital | 3,463 | 3,330 |

## Recommendations

18. The Committee is recommended to note:-

    i. the financial report for the nine months to December 2016

    ii. the updated forecast to March 2017

    iii. the capital adequacy position of LCIV as at December 2016

## Financial Implications

19. The financial implications are contained within the body of the report.

## Legal implications

20. There are no legal implications for the Committee that have not been considered in the report.

## Equalities implications

21. There are no equalities implications for the Committee.

LONDON CIV

# Pensions CIV Sectoral Joint Committee

Item no: 6

# Investment Advisory Committee Update

| | | | |
|---|---|---|---|
| **Report by:** | Ian Williams | **Job title:** | Chair of Investment Advisory Committee |
| **Date:** | 8 February 2017 | | |
| **Contact Officer:** | Jill Davys | | |
| **Telephone:** | 020 7934 9968 | **Email:** | Jill.davys@londoncouncils.gov.uk |


**Summary**

The Investment Advisory Committee (IAC) continues to work closely with the London CIV on a wide range of investment related projects.


Recommendations

The committee is recommended to:

i. Note the contents of this report;

# London CIV Investment Advisory Committee Update December 2016 – January 2017

**Introduction**

1. The Investment Advisory Committee (IAC) was formed in September 2015 with the remit to:
    i. To support the Joint Committee in the investment decision making process
    ii. To liaise with the Fund Operator of the CIV in defining Shareholders' investment needs.

2. Since the last Joint Committee meeting the IAC has formally met twice in December and January, in addition, the Treasurers from the IAC have continued to work with the London CIV Management Team on the proposals for the London CIV financial plan and budget.
3. Other key areas for discussion for the meetings have surrounded the global equity procurement, developments for fixed income, how and when infrastructure should be progressed and stewardship of investments.

**Global Equities**

4. Further to the update provided to this Committee in December on the global equities procurement, the IAC received a presentation from LCIV and briefing notes on the shortlisted managers and those being put forward for recommendation to the LCIV Board. A survey of Fund views in respect of likely future global equity product requirements was also reviewed and consideration given to the timing of sub-fund openings.
5. LCIV provided a presentation setting out the findings of the global equity selection process, setting out the rationale for manager selection including fee scales and performance. Key points arising from the meeting were:
    i. Agreed that the Committee will note the recommendations from the CIV, although clearly the decision on the appointment remains with the CIV Board.
    ii. The paperwork provided was very helpful and that it was evident that the exercise had been a very thorough process with London Fund involvement from the GE sub-group.
    iii. The involvement of the global equity working group comprising a number of borough officers has been a crucial element in the procurement process.
    iv. Results from the survey of Local Authority Pension Funds would indicate that there is strong demand for global equity income strategies, with reasonable demand for sustainable equity, emerging market and value strategies.
    v. The IAC were keen to understand in more detail the decision making process following the selection and how soon strategies would be available for Funds to invest.

vi. Comments received from an adviser involved in the procurement process were supportive of the selected managers for the respective investment strategies.

vii. The IAC sought assurances that the selection process for managers had included their general approach to environmental, social and governance factors, which the global equity sub-group were able to confirm.

viii. There was some concern from the IAC about how the relationship with existing managers would be managed where these had not been selected and this was to be raised in correspondence.

ix. Questions were raised over how Funds would transition from existing managers and whilst this would be a matter for individual Funds following decisions at Committee on the investment strategy selection, the CIV was working with the National Frameworks group to look at a procurement exercise for transition managers.

x. It was agreed that the Chair of the IAC should compile a letter and circulate for comment setting out the views of the IAC on the global equity process to be sent to the Chair of the CIV Board (a copy of which is attached in the Annex to this report).

xi. The IAC were also keen to understand how details of the new investment strategies and managers would be disseminated to the London Funds to enable them to make informed decisions and look forwards to seeing these details including information days and briefing notes.

**Fixed Income / Cashflow Products**

6. Members will recall that the IAC has also previously asked the CIV to bring forwards work in this area in acknowledgement of the pressure that some Funds are facing increasing pressure to find secure income streams to meet cashflow needs. The IAC have reviewed the results of a survey alongside participating in a dedicated fixed income / cashflow seminar organised by LCIV, which was well attended and received very positive feedback. Feedback from that seminar and the survey should now feed into the work being the sub-group and the CIV to come forward with proposals in this area and the IAC look forward to working with the CIV and hearing of the progress of this project.

**Stewardship**

7. The IAC Stewardship Working Group has also been working closely with the CIV to review the requirements of the new Investment Strategy Statements that Funds are required to publish by 1st April, which include how they will approach Pooling, ESG issues and Voting. The IAC considered this at its meeting in January and agreed that the wording be circulated to all London Funds. Whilst acknowledging that it is for individual Funds to determine these policy matters, the IAC recognise that it would be helpful to have a reasonably cohesive approach in order to avoid too many conflicting priorities which make delivery of such policies unrealistic for the CIV to implement at a pool level.

8. The IAC also considered the draft Stewardship Code Compliance Statement for the CIV, which had also been reviewed and agreed by both the Officer and Member Stewardship Working Groups.

9. The IAC also discussed the Stewardship Seminar being organised by the CIV and input into the agenda.

**Infrastructure / Housing**

10. The IAC reviewing current allocations in this area note that currently London Funds have less than 1% invested in infrastructure. It is recognised that the asset class itself means very different things to different people covering a whole range from established infrastructure which produce consistent income streams such as utility companies to green field projects which are effectively ‘holes in the ground’ and it is perhaps essential to understand where Funds are in this area in terms of the risk/reward profile that they are looking for.

11. The IAC acknowledged that some initial work has been done in the area of infrastructure including a discussion paper produced by Hermes and a couple of specific deals which have been shared with some of the London Funds.

12. The IAC received a report on social housing which had been arranged by one of the London Funds and whilst acknowledging that it could be of interest to some Funds, it may have a limited appeal to the wider group and there was concern expressed that any further development on this area by the CIV at this time could deflect resources from other ongoing key projects. It was however, recognised that some Funds may wish to pursue investments in this area on their own.

13. The IAC have discussed how much of a priority infrastructure and housing should be for the CIV. Whilst recognising that some Funds may be keen to see opportunities in this area, the IAC is also conscious that Funds have significant requirements for fixed income/cashflow products and for the global equity options and have concerns that these high demand areas to meet Fund needs, might be impacted by diverting CIV resources at this time into infrastructure. The IAC are of course mindful that Funds may well look to allocate to this area, but these are likely to be relatively small proportions compare to their need for fixed income and global equities products. The IAC are keen to engage with Members to understand the extent of the demand for infrastructure and housing and if this to be an area of priority for the CIV, what type of investments are required and how much of an allocation across London is likely to be invested in this area over the next year or whether this could receive more of a focus once some of the other key projects have been delivered.

**Additional Items**

14. **MiFID II** - The IAC encouraged Funds to respond to the MiFID II consultation and noted the response submitted by the CIV to this. They received an update at the January meeting which covered the establishment of a working group at a cross-pool level to work closely with the FCA to see if changes can be made to the criteria to assist with the opt-up criteria for LGPS Funds. A volunteer from the IAC will also be sitting on this group and reporting back.

15. **Reporting and Transparency** – The IAC has established a further working group to work closely with London CIV to develop comprehensive Reporting Framework to meet the needs of the London Funds in both statutory and wider reporting and received feedback from the first meeting of the group.

16. **Passive Management** – The IAC reviewed the draft proposals for the passive fee management charge by the CIV and proposed some amendments, which are being included in the proposals before this Committee.

17. **Academies** – At its last meeting the IAC reviewed a note regarding Academies and ongoing discussions with the Department for Education. This raised a number of concerns for Funds including the potential for academies to be taken out of Local Authority Pension Funds into a separate central Academy Pool. This could cause issues for Funds in terms of funding levels, cashflow and staffing and could also promote faster conversions. Whilst this may not at first glance appear to affect LCIV, it could ultimately impact on the level of assets that would be available to transition into the London CIV and into other Pools being established around the Country affecting delivery of the Criteria and Guidance set out by Government.

18. **Actuarial Valuation** – The IAC has been working closely with the Society of London Treasurers to collate the actuarial valuation results via a survey and has reviewed updates at the IAC meetings. Given that there had been some major concerns going into the valuation period around what funding would look like, the results that have come through in the survey have actually painted a slightly better position than many had feared. Funding positions have generally improved, deficit recovery periods shortened and contribution increases minimised.

19. **Governance Review of the London CIV** – Treasurers represented on the IAC have also been working closing with the CIV to look at the scoping of the governance review to ensure that it covers key areas including but not limited to the committee structures, roles and responsibilities, composition and the key decision making processes. The IAC treasurers look forwards to working with the CIV feeding into the review as required and to considering the findings in due course. The scoping document is due to be presented to Leaders Committee for consideration in due course.

20. **Future work** – The IAC will continue to work closely with the CIV on key projects to help ensure that they are able to deliver the investment strategies that the Funds need to meet their requirements. In recognition of this the IAC have requested a 12 month work plan for consideration at the next meeting in February.

**Recommendations**

21. The committee is recommended to:

    i. Note the contents of this report

**Financial implications**

22. There are no financial implications for London Councils

**Legal implications**

23. There are no legal implications for London Councils.

**Equalities implications**

24. There are no equalities implications for London Councils

**Annex A** – Letter to the Chair of LCIV from the Chair of the IAC

**Hackney**

Mr Ian Williams

Group Director of Finance and
Corporate Resources/ Chair of IAC
London Borough of Hackney
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**Baron Kerslake**

**Chair**

**London CIV**

Date: 26th January 2017

**Letter from IAC regarding Global Equity Procurement to the Investment Oversight Committee and Board**

Dear Baron Kerslake,

As Chair of the Investment Advisory Committee (IAC), I wanted to write to you and the Board to feedback from the IAC in respect of the recent global equity tender that has been undertaken by the CIV on behalf of London Borough Pension Funds.

At our last IAC meeting held in December 2016, the IAC received a presentation setting out the preferred manager selections for the global equity strategies. The Committee wanted to emphasise to both the Investment Team at the CIV and the Global Equity Working Group of the IAC, how impressed we were with the process of the procurement, the fact that they had been kept informed of progress on a monthly basis and it was clear that an extensive amount of work had clearly been undertaken. It is clear that this has been a very extensive exercise requiring significant resource dedicated to delivering the best outcomes for London Funds. In particular it was felt:

- There was clear recognition that global equities was by far and away the largest asset class across London and whilst the CQC approach has delivered for a number of London Funds, there are others who have not been able to participate in the early stages because their managers were part of the process on early on-boarding. Therefore it was going to be helpful to have a wider range of managers to choose from, particularly in the global equity income and sustainable space where funds currently don't have much exposure. A number of funds have held off undertaking their own procurement exercise awaiting the outcome of the CIV procurement programme and are keen to see new opportunities as soon as possible.

- The inclusion of a dedicated group of pension managers on the global equity sub-group provided assurance that the views of funds are being taken into account as well as being able to confirm the robustness of the process for Funds.

- This has been a significant exercise and the IAC wanted to acknowledge the amount of work that has been undertaken by the CIV Investment Team in delivering a detailed robust exercise on behalf of London Funds

- The views of the selected managers from the IAC were in the majority supported by one of the leading LGPS consultants across London, who had been involved in the initial stages of the procurement exercise. It is recognised that other consultants will need to be briefed on the chosen managers in order to support the selections at Pension Committee meetings.

- Going forwards the IAC are keen to understand the decision making process once the preferred managers have been selected. They understand their role in the decision process is to satisfy themselves of the robustness of the decisions being put forward, which they have been and now want to understand how the final decision is made so that fund openings can be progressed swiftly.

- The IAC are also keen to understand in more depth how the transition process to the new managers will operate, in particular how the relationship with long standing managers will be managed where they haven't been selected for particular strategies. The IAC acknowledge the CIV have agreed to be part of the National Framework for Transition managers and recognise that this will facilitate the transition process for London Funds, they are also keen to understand in more depth the transition costs that Funds will incur when moving managers, particularly where this would be occurring outside of the normal investment strategy process. Funds are also still keen to understand how long standing relationships will be managed with unselected managers. The IAC are also keen to understand from the IOC and Board what their views are regarding why Funds would undertake a transition from existing managers to the new ones on the CIV platform. In addition, we recognise the need for pace so that the investment vehicles available meet pension fund requirements.

- Whilst recognising that the Fund's survey had suggested that historic performance was an important factor, they were also keen to understand in more detail how they would deliver performance going forwards. It is acknowledged that this is covered in the detailed briefing notes and was further illuminated in discussions at the Committee meeting, but some more detail around this would be helpful as will the opportunity to hear from the managers direct.

- The Committee were also keen to understand the Environmental, Social and Governance aspects of each of the selected managers, if these could be covered in the manager notes, this would be a helpful addition for Funds that place greater emphasis on these aspects. This should also cover whether the manager has particular approach to fossil fuel and low carbon.

In conclusion, the IAC would like to express their appreciation for the work put in by the Investment Team for ensuring the involvement of the Boroughs in the procurement exercise and for delivering a detailed robust process to the IAC. There are naturally a number of concerns given that this is the first time the process has been undertaken and some clarity about the governance process from here. Borough funds are really keen to ensure that the pace of providing the investment vehicles is considered a priority and that the CIV focuses on doing the high priority areas of work. Finally, it is clear to members of the IAC that the scheduled governance review is important to the London Boroughs to ensure that the confidence is maintained in order for the transition of further £billions of the Pension Fund Investments.

Yours sincerely,

Ian Williams

**Ian Williams**
Group Director of Finance and Corporate Resources
London Borough of Hackney
Chair of the IAC

# Pensions CIV Sectoral Joint Committee

Item no: 8

## London CIV Stewardship Update



| | | | |
|---|---|---|---|
| **Report by:** | Jill Davys | **Job title:** | Assistant Director, London CIV |
| **Date:** | 8 February 2017 | | |
| **Telephone:** | 020 7934 9968 | **Email:** | Jill.davys@londonciv.gov.uk |




**Summary:** At its meeting of 13 December 2016 the committee considered a report from London Councils covering constitutional matters associated with this Sectoral Joint Committee. This report provides a further update to Members and proposals for taking forward a wider governance review of all the arrangements pertaining to London CIV and the participating London local authorities, before making any changes that would have a direct impact on this committee.


**Recommendations:** The committee is recommended to:

i. Consider and note the contents of this report

ii. Approve the LCIV draft Stewardship Code Statement of Compliance

# London CIV Stewardship Update

## Background

1. The London CIV as a regulated fund manager looking after the assets of the London Local Authority Pension Funds takes its stewardship responsibilities seriously recognising that good stewardship plays a key role in the management of assets delivering long term financial benefits.

2. The Joint Committee has established a Member working group to work closely with the CIV to develop stewardship activities including the drafting of a Stewardship Code Statement of Compliance, which is now coming before this Committee for consideration prior to the Board Meeting of the London CIV and submission to the Financial Reporting Council (FRC).

3. The Member Stewardship Working Group met on 16 January 2017 (minutes attached at Annex A for information) to consider the draft Stewardship Statement. The Stewardship Code aims to enhance the quality of engagement between asset managers and companies to help improve long-term risk-adjusted returns to shareholders. It was first published in July 2010 and the Code was revised in September 2012. The Code sets out a number of areas of good practice to which the FRC believes institutional investors should aspire. It also describes steps asset owners can take to protect and enhance the value that accrues to the ultimate beneficiary. The FRC sees the UK Stewardship Code as complementary to the UK Corporate Governance Code for listed companies and, like that Code, it should be applied on a 'comply or explain' basis.

4. Since December 2010 all UK-authorised Asset Managers are required under the FCA's Conduct of Business Rules to produce a statement of commitment to the Stewardship Code or explain why it is not appropriate to their business model.

5. In 2016 the FRC assessed signatories to the Stewardship Code based on the quality of their Code statements. This work was undertaken to improve the quality of reporting against the Code, encourage greater transparency in the market and maintain the credibility of the Code. Tiering distinguishes between signatories who report well and demonstrate their commitment to stewardship, and those where reporting improvements are necessary. The tiering exercise has improved the quality of reporting against the Code, promoted best practice and resulted in greater transparency in the UK market.

6. Asset manager signatories have been categorised in three tiers, with asset owners and service providers being categorised in two tiers. The FRC has stated that the additional tier for asset managers reflects the greater relevance of the Code’s provisions to asset managers, their role as agents and the wide range of reporting quality.

7. Officers of the CIV and the officer stewardship working group met with the FRC to discuss the position of the London CIV in the reporting structure and to seek guidance on how assessments are undertaken. Following these discussions, the London CIV has now drafted a Statement of Compliance with the Code, which has been agreed with the Stewardship Working Group, a copy of this is attached at Annex B for consideration by the Joint Committee.

8. Whilst the London CIV is a regulated fund manager, at this time all of the investments are managed externally. This puts the London CIV in a similar position to a number of other collective funds which have been classified as asset owner rather than asset managers. It would seem appropriate at this stage of the London CIV development to aim for a Tier One classification as an asset owner rather than as an asset manager. Also attached at Annex C is the FRC Stewardship Code for information.

9. Officers have also reviewed the status of the managers on the London CIV platform following the tiering classification by the FRC. All with the exception of Pyrford have met the criteria for a tier one, who has achieved a level two status.

10. Members should also be aware that individual funds under the new guidance for the Investment Strategy Statement (ISS) which is required to be issued by 1st April 2017, also have to include an explanation on their policy on stewardship with reference to the Stewardship Code. London Funds may therefore find the draft statement useful when either compiling their own statement or setting out their approach to Stewardship in their ISS.

11. With Funds in the process of drafting their ISS, Members will be aware that the 2016 Regulations also require funds to set out their approach to voting and engagement more broadly. Whilst recognising that it is absolutely for Funds to determine their own policies, the officer working group has been liaising with the London CIV to see if some generic wording could be developed to assist Funds in compiling these aspects of the ISS. With 33 London Local Authorities, it is recognised that there is likely to be a wide dispersion of approaches to these statements and this could result in additional complexity when assets transfer to the CIV if there is not some flexibility built into statements or they would ultimately conflict with what the CIV is able to provide by way of voting and stewardship. The draft wording agreed with the officer working group is attached at Annex D for information and also covers the pooling statements. This has also been reviewed by the Investment Advisory Committee and they have endorsed the approach and options being put forward.

12. Members have also requested that a report be brought to this Committee on the National Frameworks Stewardship Framework. At this time, the final touches are still being put to this Framework in terms of legal agreements and therefore it is not currently operational. However in brief the Stewardship Framework will enable both Funds and Pools to access providers offering a range of services in connection with stewardship. There are 5 lots under the Framework as set out below:

    i. Lot 1 Voting Services – support for the design, implementation and reporting of your voting activity

    ii. Lot 2 Engagement Services – support for the design, implementation and reporting of your engagement activity

    iii. Lot 3 Voting and Engagement Services – support for the design, implementation and reporting of your voting and engagement activity

    iv. Lot 4 Stewardship Research and Data Services - provision of data/research at sectoral, regional, asset class and/or investment level of environmental, social, governance and other stewardship matters in relation to your current or prospective investments

v. Lot 5 Stewardship-related Project Services - Discrete pieces of specialist, stewardship-related project work

13. Once the Framework is operational, the London CIV will provide a further update on the providers and types of service available.

**Recommendations**

14. The committee is recommended to:

i. Consider and note the contents of this report

ii. Approve the LCIV draft Stewardship Code Statement of Compliance

**Legal Implications**

15. There are no legal implications at this time.

**Financial implications**

16. There are no financial implications for London Councils

**Equalities Implications**

17. There are no equalities implications for London Councils

**Attachments**

Annex A – Member Stewardship Working Group Minutes 16 January 2017

Annex B – London CIV Draft Stewardship Code Compliance Statement

Annex C – FRC Stewardship Code

Annex D – Suggested wording for Investment Strategy Statements

# PENSIONS SECTORAL JOINT COMMITTEE – LONDON CIV

## Stewardship Working Group

### 16th January 2017 – Minutes

**Attendees:**

| **Borough** | **Representative** |
|---|---|
| Ealing | Cllr Yvonne Johnson (YJ), Chair |
| Hackney | Cllr Rob Chapman (RC) |
| Islington | Cllr Richard Greening (RG) |
| Richmond | Cllr Thomas O'Malley (TOM) |
| Wandsworth | Cllr Maurice Heaster (MH), Vice Chair |

**London CIV**

| | |
|---|---|
| Chief Executive | Hugh Grover (HG) |
| AD, Client Management | Jill Davys (JD) |

| Agenda Item Number | Agenda Item | Actions |
|---|---|---|
| 1. | **Apologies:**<br>Cllr Toby Simon (Enfield) | |
| 2. | **Minutes and Matters Arising**<br><br>Minutes Agreed<br>Matters Arising:<br>• LCIV Monitoring and managing voting alerts and informing managers as they arise. Quarterly reporting to PSJC on voting included in the Investment Updates. Noted that around 2/3rds of London Funds participate in LAPFF, RG commented Islington also use PIRC for voting, recognition that if LCIV used, this would lead to additional costs.<br>• Stewardship Code, Seminar and future dates picked in the main agenda<br>• RC and YJ asked if it was possible for the CIV to look into a London wide offering for carbon tracking to negotiate better rates for the tracking of carbon investments. JD replied that the CIV was currently working on a template IMA which would require the managers it invests with to provide disclose on their carbon footprint and to provide reporting. JD would also approach providers to ask about wider carbon reporting for funds. | JD to approach carbon tracking providers to look at options for a wider London framework for monitoring carbon exposure |

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| 3. | **Stewardship Code – Draft Compliance Statement**<br><br>The Committee reviewed the draft Code of Compliance with the Stewardship Code. JD and a colleague from LB Hackney had met with the FRC to discuss the options for LCIV and the Stewardship Code. Whilst LCIV is a fund manager, the asset owner category for compliance would seem more appropriate at this stage in its development. For Asset managers, there are 3 levels of compliance (level 1 being the highest), but the standards to achieve level 1 would require additional resources for the CIV to be able to demonstrate compliance. Asset Owners are classified in 2 levels (with most funds in London with a statement having achieved the second level). LCIV would be looking to achieve the highest level as an asset owner (there are other precedents of similarly structured funds in the asset owner category). The Statement had been reviewed by the officer stewardship working group and was now coming before this Committee for consideration in advance of presenting to the PSJC. TOM suggested that further enhancements be made to the voting section that LCIV would include a voting and engagement report in its annual report and accounts and also on the website. Also need to include some comments that for the purpose of the Code, LCIV was acting as asset owners rather than an asset manager – agreed that JD would incorporate suggestions in the final version. A question was raised over the cost of ensuring compliance with the code – would this require additional resources for the CIV? It was agreed that a Level 1 Compliance Statement would not require additional resources at this stage and would be managed by the Client Manager. JD to amend Statement and forward to FRC for review. | JD to include additional wording on voting in the Statement in advance of sending to FRC for comment |

| | | |
|---|---|---|
| 4. | **Global Equity Procurement:**<br><br>Members reviewed the confidential report on the sustainable equities Lot from the global equities procurement exercise, along with the survey which had been carried out amongst the London Funds. JD commented that the proposed manager for sustainable equities did not have an exclusion approach, rather the manager looked for companies which had a sustainable approach to its business, which therefore tended to mean low exposures to sectors such as those exposed to carbon risks. Recognition that a number of Funds across London were experiencing significant pressure from the Divest movement and that at some point LCIV might need a more focused 'no carbon' offering. Overall the group felt that engagement with companies was a better approach than outright divestment at this stage. | |

| | | |
|---|---|---|
| | MH commented that the survey was useful in identifying where Funds were looking to invest in the global equity area with particular reference to the equity income space. LCIV are looking to open 3-4 sub-funds over the summer and this would include both equity income and sustainable equities. Further sub-funds would follow later in the year, but these were still to be decided.<br><br>The Working Group was also keen to understand how the CIV can assist London Funds in implementing their investment strategies, particularly as these were currently under review following the valuation. The CIV is already conducting surveys and working closely with the investment consultants along with the Funds themselves to better understand the needs of the Funds. | |
| 5. | **Stewardship Seminar:**<br><br>The Committee were broadly happy with the content of the Seminar, but asked that it finish by 4.30 even if this meant removing a refreshment break. This would enable Members to travel back from the event in time to attend evening meetings. | |
| 5. | **Dates of Future Meetings:**<br><br>The Group were content to have a further meeting in the summer, dates to be proposed by LCIV | JD to provide possible dates for further meetings |
| 6. | **A.O.B**<br><br>None raised | |

# LONDON CIV

# STEWARDSHIP CODE

# STATEMENT OF COMPLIANCE

# LONDON CIV

# UK STEWARDSHIP CODE STATEMENT

The London Collective Investment Vehicle (CIV) was formed as a voluntary collaborative venture by the London Local Authorities in 2014 to invest the assets of London Local Government Pension Scheme (LGPS). The London CIV and its London Local Authority investors recognise the importance of being long term stewards of capital and in so doing supports the UK Stewardship Code, which it recognises as best practice.

The London LGPS CIV Limited ("London CIV") is fully authorised by the FCA as an Alternative Investment Fund Manager (AIFM) with permission to operate a UK based Authorised Contractual Scheme fund (ACS Fund). The London CIV in the management of its investments has appointed a number of external investment managers. We therefore see our role as setting the tone for the effective delivery of stewardship managers on our behalf and on behalf of our investing Funds. We are clear that we retain responsibility for this being done properly and fully in the interests of our own shareholders.

This Statement sets out how the London CIV implements the seven principles of the Code. For the purpose of the Code, London CIV is acting in the capacity of an asset owner rather than an asset manager, representing the interests of the London Local Authority LGPS Funds.

### Principle 1
**Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.**

The London CIV on behalf of its London Local Authority Shareholders recognises its position as an investor on their behalf with ultimate responsibility to members and beneficiaries and recognises that effective stewardship can help protect and enhance the long-term value of its investments to the ultimate benefit of all stakeholders in the LGPS.

As we do not invest directly in companies, we hold our fund managers accountable for the delivery of stewardship on our behalf in terms of day-to-day implementation of its stewardship activity. We require the appointed fund management teams to be responsible for holding to account the management and boards of companies in which they invest. The London CIV believes that this approach is compatible with its stewardship responsibilities as it is the most effective and efficient manner in which it can promote and carry out stewardship activities in respect of its investments, and ensure the widest reach of these activities given the CIV's investment arrangements.

A key related area where stewardship is integrated into the wider process is in the selection and monitoring of external investment managers. When considering the appointment of external investment managers the consideration of Environmental

Social and Governance (ESG) integration and stewardship activity of each investment manager is part of the selection process.
The London CIV expects its equity investment managers to adhere to the principles within the UK Stewardship Code. This position is communicated to the Fund's investment managers and forms the basis of the approach to monitoring the investment managers as outlined in this document. Whilst the Stewardship Code is primarily directed at UK equity investments, the CIV encourages its investment managers to apply the principles of the Code to overseas equity holdings where possible.

The primary mechanisms for the application of effective stewardship for the CIV are exercise of voting rights and engagement with investee companies. The CIV expects its external equity investment managers that invest directly in companies, to pursue both these mechanisms. We receive quarterly reporting from managers which includes their stewardship and voting activities where appropriate. We seek consistently to ensure that these stewardship activities are carried out actively and effectively in the furtherance of good long-term investment returns.

We expect all of the CIV's equity managers to be signatories to the Code and have publicly disclosed their policy via their Statements on how they will discharge their stewardship responsibilities. We expect managers that invest in companies directly to discharge their responsibilities by:

- having extensive dialogue with the company's management throughout the year on a range of topics such as governance, financial performance and strategy; and
- voting, either directly or via the services of voting agencies.

**Principle 2**
**Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.**

Day-to-day implementation of the Fund's stewardship activity has been delegated to external investment managers. The CIV expects its investment managers to document their approach to stewardship, which should include how they manage any conflicts of interest that arise to ensure that the interests of the CIV's Investors are prioritised. The CIV will review annually the conflicts of interest policy of its managers and how any conflicts have been managed during the year.

The London CIV has policies in place to manage conflicts of interest that may arise for the Board and its officers when making decisions on its behalf. The Conflicts of Interest policy is reviewed by the CIV board on a regular basis. A Conflicts of Interest Register is maintained.

Shareholders of the CIV attending the Pensions Sectoral Joint Committee are required to declare any conflicts of interest at the start of any meeting.

## Principle 3
**Institutional investors should monitor their investee companies.**

We recognise that active and ongoing monitoring of companies is the foundation of good stewardship, reminding companies in which we invest that they have obligations to their shareholders to deliver returns over the appropriate long-term investment timeframe and, consistent with this, to manage any related environmental and social risks responsibly.

The CIV requires its external investment managers to monitor investee companies. Issues to be monitored are likely to vary, however typically these might include a company's corporate strategy, financial performance, risk (including those from environmental and social factors), capital structure, leadership team and corporate governance. The CIV encourages its investment managers to satisfy themselves that investee companies adhere to the spirit of the UK Corporate Governance Code.

The CIV reviews investment managers in this area as part of their regular meetings. For equity investment managers this includes consideration of:

- who has overall responsibility for ESG risk analysis and integration;
- resources and experience of the team;
- at what stages of the process ESG risks are considered;
- exposures to environmental, social or governance risk within the portfolio; and
- the investment manager's willingness to become an insider and, if so, whether the manager has a policy setting out the mechanisms through which this is done.

## Principle 4
**Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.**

The CIV recognises that constructive engagement with company management can help protect and enhance shareholder value. Typically, the CIV expects its investment managers to intervene with investee companies when they view that there are material risks or issues that are not currently being adequately addressed.

The CIV reviews investment managers in this area as part of their regular meeting. For equity investment managers that invest directly in Companies, this includes consideration of:

- whether voting activity has led to any changes in company practice;
- whether the investment manager's policy specifies when and how they will escalate engagement activities;
- overall engagement statistics (volume and areas of focus);
- example of most intensive engagement activity discussed as part of the manager's annual review meeting; and
- the estimated performance impact of engagement on the strategy in question.

Given the range of fund managers and Fund investments, the CIV carries out its monitoring at the manager level to identify:

- trends to ensure progress is being made in stewardship activities;
- specific managers where progress or the rate of progress is not adequate; and
- appropriate specific actions necessary.

**Principle 5**
**Institutional investors should be willing to act collectively with other investors where appropriate.**

As day-to-day management of the Fund's assets has been delegated to external investment managers, the CIV expects its investment managers to get involved in collective engagement where this is an efficient means to protect and enhance long-term shareholder value.

In addition the London CIV will work collectively with other investors including other LGPS Asset pools and the Local Authority Pension Fund Forum (LAPFF) to enhance the impact of their engagement activities.

**Principle 6**
**Institutional investors should have a clear policy on voting and disclosure of voting activity.**

The CIV has delegated its voting rights to the Fund's investment managers and requires them to vote, except where it is impractical to do so. The CIV also monitors the voting alerts of the LAPFF and where these are issued, requires the investment managers to take account of these alerts as far as practical to do so. Where the investment manager does not vote in line with the LAPFF voting alerts, the CIV will require detailed justification for non compliance.

The CIV reviews and monitors the voting policies and activities of its investment managers, this includes consideration of:

- the manager's voting policy and, what areas are covered;
- the level of voting activity
- whether the investment manager typically informs companies of their rationale when voting against or abstaining (and whether this is typically in advance of the vote or not);
- if securities lending takes place within a pooled fund for the strategy, whether the stock is recalled for all key votes for all stocks held in the portfolio; and
- whether a third party proxy voting service provider is used and, if so, how.

**Principle 7**
**Institutional investors should report periodically on their stewardship and voting activities.**

The London CIV encourages transparency from its investment managers and expects its managers to report publicly on their voting in an appropriate manner. In addition the London CIV receives reviews and monitors quarterly the voting and stewardship engagement activities of its investment managers.

The CIV reports quarterly to its investors and will include information on voting and engagement activities from investment managers where appropriate including updates as required on updated stewardship and voting policies of managers. The CIV also requires its managers to provide it with annual assurances on internal controls and compliance through recognised framework such as the AAF01/06 or equivalent.

The CIV will incorporate a voting and engagement report in its annual report and accounts and will also place a copy of the report separately on the website.

***This statement will be reviewed regularly and updated as necessary.***

Code

Corporate Governance

Financial Reporting Council

September 2012

# The UK Stewardship Code

## Contents

## Stewardship and the Code

1. Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.

2. In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.

3. The UK Corporate Governance Code identifies the principles that underlie an effective board. The UK Stewardship Code sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the "comply or explain" system.

4. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.

5. Institutional investors' activities include decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling specific securities. The division of duties within and between institutions may span a spectrum, such that some may be considered asset owners and others asset managers.

6. Broadly speaking, asset owners include pension funds, insurance companies, investment trusts and other collective investment vehicles. As the providers of capital, they set the tone for stewardship and may influence behavioural changes that lead to better stewardship by asset managers and companies. Asset managers, with day-to-day responsibility for managing investments, are well positioned to influence companies' long-term performance through stewardship.

7. Compliance with the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.

## Application of the Code

1. The UK Stewardship Code traces its origins to 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles,' first published in 2002 by the Institutional Shareholders Committee (ISC), and which the ISC converted to a code in 2009. Following the 2009 Walker Review of governance in financial institutions, the FRC was invited to take responsibility for the Code. In 2010, the FRC published the first version of the UK Stewardship Code, which closely mirrored the ISC code. This edition of the Code does not change the spirit of the 2010 Code.

2. The Code is directed in the first instance to institutional investors, by which is meant asset owners and asset managers with equity holdings in UK listed companies. Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their responsibility for stewardship. They remain responsible for ensuring those activities are carried out in a manner consistent with their own approach to stewardship. Accordingly, the Code also applies, by extension, to service providers, such as proxy advisors and investment consultants.

3. The FRC expects signatories of the Code to publish on their website, or if they do not have a website in another accessible form, a statement that:

   - describes how the signatory has applied each of the seven principles of the Code and discloses the specific information requested in the guidance to the principles; or
   - if one or more of the principles have not been applied or the specific information requested in the guidance has not been disclosed, explains why the signatory has not complied with those elements of the Code.

4. Disclosures under the Code should improve the functioning of the market for investment mandates. Asset owners should be better equipped to evaluate asset managers, and asset managers should be better informed, enabling them to tailor their services to meet asset owners' requirements.

5. In particular the disclosures should, with respect to conflicts of interest, address the priority given to client interests in decision-making; with respect to collective engagement, describe the circumstances under which the signatory would join forces with other institutional investors to ensure that boards acknowledge and respond to their concerns on critical issues and at critical times; and, with respect to proxy voting agencies, how the signatory uses their advice.

6. The statement of how the Code has been applied should be aligned with the signatory's role in the investment chain.

7. Asset owners' commitment to the Code may include engaging directly with companies or indirectly through the mandates given to asset managers. They should clearly communicate their policies on stewardship to their managers. Since asset owners are the primary audience of asset managers' public statements as well as client reports on stewardship, asset owners should seek

to hold their managers to account for their stewardship activities. In so doing, they better fulfil their duty to their beneficiaries to exercise stewardship over their assets.

8. An asset manager should disclose how it delivers stewardship responsibilities on behalf of its clients. Following the publication in 2011 of the Stewardship Supplement to Technical Release AAF 01/06, asset managers are encouraged to have the policies described in their stewardship statements independently verified. Where appropriate, asset owners should also consider having their policy statements independently verified.

9. Overseas investors who follow other national or international codes that have similar objectives should not feel the application of the Code duplicates or confuses their responsibilities. Disclosures made in respect of those standards can also be used to demonstrate the extent to which they have complied with the Code. In a similar spirit, UK institutions that apply the Code should use their best efforts to apply its principles to overseas equity holdings.

10. Institutional investors with several types of funds or products need to make only one statement, but are encouraged to explain which of their funds or products are covered by the approach described in their statements. Where institutions apply a stewardship approach to other asset classes, they are encouraged to disclose this.

11. The FRC encourages service providers to disclose how they carry out the wishes of their clients with respect to each principle of the Code that is relevant to their activities.

12. Signatories are encouraged to review their policy statements annually, and update them where necessary to reflect changes in actual practice.

13. This statement should be easy to find on the signatory's website, or if they do not have a website in another accessible form, and should indicate when the statement was last reviewed. It should include contact details of an individual who can be contacted for further information and by those interested in collective engagement. The FRC hosts on its website the statements of signatories without their own website.

14. The FRC retains on its website a list of asset owners, asset managers and service providers that have published a statement on their compliance or otherwise with the Code, and requests that signatories notify the FRC when they have done so, and when the statement is updated.

15. The FRC regularly monitors the take-up and application of the Code. It expects the content of the Code to evolve over time to reflect developments in good stewardship practice, the structure and operation of the market, and the broader regulatory framework. Unless circumstances change, the FRC does not envisage proposing further changes to the Code until 2014 at the earliest.

Financial Reporting Council
September 2012

## Comply or Explain

1. As with the UK Corporate Governance Code, the UK Stewardship Code should be applied on a "comply or explain" basis.

2. The Code is not a rigid set of rules. It consists of principles and guidance. The principles are the core of the Code and the way in which they are applied should be the central question for the institutional investor as it determines how to operate according to the Code. The guidance recommends how the principle might be applied.

3. Those signatories that choose not to comply with one of the principles, or not to follow the guidance, should deliver meaningful explanations that enable the reader to understand their approach to stewardship. In providing an explanation, the signatory should aim to illustrate how its actual practices contribute to good stewardship and promote the delivery of the institution's or its clients' investment objectives. They should provide a clear rationale for their approach.

4. The Financial Services Authority requires any firm authorised to manage funds, which is not a venture capital firm, and which manages investments for professional clients that are not natural persons, to disclose "the nature of its commitment" to the Code or "where it does not commit to the Code, its alternative investment strategy" (under Conduct of Business Rule 2.2.3[1]).

5. The FRC recognises that not all parts of the Code are relevant to all signatories. For example, smaller institutions may judge that some of its principles and guidance are disproportionate in their case. In these circumstances, they should take advantage of the ''comply or explain'' approach and set out why this is the case.

6. In their responses to explanations, clients and beneficiaries should pay due regard to the signatory's individual circumstances and bear in mind in particular the size and complexity of the signatory, the nature of the risks and challenges it faces, and the investment objectives of the signatory or its clients.

7. Whilst clients and beneficiaries have every right to challenge a signatory's explanations if they are unconvincing, they should not evaluate explanations in a mechanistic way. Departures from the Code should not be automatically treated as breaches. A signatory's clients and beneficiaries should be careful to respond to the statements from the signatory in a manner that supports the "comply or explain" process and bears in mind the purpose of good stewardship. They should put their views to the signatory and both parties should be prepared to discuss the position.

[1] http://fsahandbook.info/FSA/html/handbook/COBS/2/2

## The Principles of the Code

So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

# The UK Stewardship Code

## Principle 1

**Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.**

### Guidance

Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.

The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.

The statement should reflect the institutional investor's activities within the investment chain, as well as the responsibilities that arise from those activities. In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.

Where activities are outsourced, the statement should explain how this is compatible with the proper exercise of the institutional investor's stewardship responsibilities and what steps the investor has taken to ensure that they are carried out in a manner consistent with the approach to stewardship set out in the statement.

The disclosure should describe arrangements for integrating stewardship within the wider investment process.

## Principle 2

**Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.**

### Guidance

An institutional investor's duty is to act in the interests of its clients and/or beneficiaries.

Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

## Principle 3

### Institutional investors should monitor their investee companies.

### Guidance

Effective monitoring is an essential component of stewardship. It should take place regularly and be checked periodically for effectiveness.

When monitoring companies, institutional investors should seek to:

- keep abreast of the company's performance;
- keep abreast of developments, both internal and external to the company, that drive the company's value and risks;
- satisfy themselves that the company's leadership is effective;
- satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members;
- consider the quality of the company's reporting; and
- attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

Institutional investors should consider carefully explanations given for departure from the UK Corporate Governance Code and make reasoned judgements in each case. They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position.

Institutional investors should endeavour to identify at an early stage issues that may result in a significant loss in investment value. If they have concerns, they should seek to ensure that the appropriate members of the investee company's board or management are made aware.

Institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.

Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.

## Principle 4

### Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

### Guidance

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the company's advisers;
- meeting with the chairman or other board members;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of General Meetings;
- submitting resolutions and speaking at General Meetings; and
- requisitioning a General Meeting, in some cases proposing to change board membership.

## Principle 5

### Institutional investors should be willing to act collectively with other investors where appropriate.

### Guidance

At times collaboration with other investors may be the most effective manner in which to engage.

Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.

Institutional investors should disclose their policy on collective engagement, which should indicate their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure companies are aware of concerns. The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.

### Principle 6

### Institutional investors should have a clear policy on voting and disclosure of voting activity.

### Guidance

Institutional investors should seek to vote all shares held. They should not automatically support the board.

If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records.

Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

Institutional investors should disclose their approach to stock lending and recalling lent stock.

### Principle 7

### Institutional investors should report periodically on their stewardship and voting activities.

### Guidance

Institutional investors should maintain a clear record of their stewardship activities.

Asset managers should regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported and the format used, should be a matter for agreement between agents and their principals.

Asset owners should report at least annually to those to whom they are accountable on their stewardship policy and its execution.

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

Asset managers that sign up to this Code should obtain an independent opinion on their engagement and voting processes having regard to an international standard or a UK framework such as AAF 01/06[2]. The existence of such assurance reporting should be publicly disclosed. If requested, clients should be provided access to such assurance reports.

[2] Assurance reports on internal controls of service organisations made available to third parties: http://www.icaew.com/en/technical/audit-and-assurance/assurance/technical-release-aaf-01-06

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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**LONDON LOCAL AUTHORITY PENSION FUNDS - INVESTMENT STRATEGY STATEMENTS**

**Suggested Draft Wording for Pooling, ESG and Voting**

**Regulation 7(2)(d) - The approach to pooling investments, including the use of collective investment vehicles and shared services**

The Fund has formally agreed to join the London Collective Investment Vehicle (CIV) as part of the Government's pooling agenda. The London CIV has been operational for some time and is in the process of opening a range of sub-funds covering liquid asset classes, with less liquid asset classes to follow.

*(Please insert as appropriate – liquid assets)*

*(a) The Fund has already transitioned assets into the London CIV with a value of £xm or x% of the assets and will look to transition further liquid assets as and when there are suitable investment strategies available on the platform that meet the needs of the Fund.*

*(b) The Fund will transition liquid assets into the London CIV when there are suitable investment strategies that meet the asset allocation and investment strategy available on the London CIV platform. The Fund anticipates being able to transition some of the liquid assets across in advance of April 2018.*

*(c) The Fund is monitoring developments and the opening of investment strategy fund openings on the London CIV platform with a view to transitioning liquid assets across to the London CIV as soon as there are suitable sub-funds to meet the Fund's investment strategy requirements.*

*(Please insert as appropriate – passive life funds and other life funds)*

*The Fund holds x% £m of its assets in life funds and intends to retain these outside of the London CIV in accordance with government guidance on the retention of life funds outside pools for the time being. The Fund agrees for the London CIV to monitor the passive funds as part of the broader pool*

*(Please insert as appropriate –illiquid assets)*

*The Fund holds £m or x% of the Fund held in illiquid assets and these will remain outside of the London CIV pool. The cost of exiting these strategies early would have a negative financial impact on the Fund. These will be held as legacy assets until such time as they mature and proceeds re-invest through the pool assuming it has appropriate strategies available or until the Fund changes asset allocation and makes a decision to disinvest.*

**Regulation 7(2)(e) - How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments**

The Fund is committed to being a long term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. *In addition the Pensions Committee undertakes training on a regular basis and this will include on training and information sessions on matters of social, environmental and corporate governance.*

The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It expects its managers to follow good practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed.

The Fund expects its external investment managers (and specifically the London Collective Investment Vehicle through which the Fund will increasingly invest) to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the fund such as corporate governance and environmental factors. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making.

Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors to the extent these directly or indirectly impact on financial risk and return.

The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

**Regulation 7(2)(f) - The exercise of rights (including voting rights) attaching to investments**

The Fund recognises the importance of its role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Fund recognises that ultimately this protects the financial interests of the Fund and its ultimate beneficiaries. The Fund has a commitment to actively exercising the ownership rights attached to its investments reflecting the Fund's conviction that responsible asset owners should maintain oversight of the companies in which it ultimately invests recognising that the companies' activities impact upon not only their customers and clients, but more widely upon their employees and other stakeholders and also wider society.

*(Please insert as appropriate)*

*(a) The Fund has appointed a dedicated voting provider and has delegated voting its holdings in investee companies in accordance with the Fund's voting policy, which is set out (below / in a separate document).*

*(b) The Fund has delegated responsibility for voting rights to the Fund's external investment managers and expects them to vote in accordance with the Fund's voting policy as set out (below / in a separate document).*

*(c) The Fund's investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the Pensions Sectoral Joint Committee. Voting is delegated to the external managers and monitored on a quarterly basis. The CIV will arrange for managers to vote in accordance with voting alerts issued by the Local Authority Pension Fund Forum as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions.*

The Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the *Council / Pension* Fund website: …….

*(Please insert as appropriate)*

*(a) The Fund has issued a Statement of Compliance with the Stewardship Code which can be found on the Council / Pension Fund website.*

*(b) The Fund has reviewed the London CIV Statement of Compliance with the Stewardship Code and has agreed to adopt this Statement.*

*(c) The Fund has not issued a separate Statement of Compliance with the Stewardship Code, but fully endorses the principles embedded in the 7 Principles of the Stewardship Code.*

*(d) The Fund expects its external investment managers to be signatories of the Stewardship Code and reach Tier One level of compliance or to be seeking to achieve a Tier One status within a reasonable timeframe. Where this is not feasible the Fund expects a detailed explanation as to why it will not be able to achieve this level.*

In addition, the Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly.

The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which invests.:

*(Please insert as appropriate)*

*In addition the Fund:*

*(a) is a member of the Local Authority Pension Fund Forum (LAPFF) and in this way joins with other LGPS Funds to magnify its voice and maximise the influence of investors as asset owners*

*(b) is a member of the Pension and Lifetime Savings Association (PLSA) and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners*

*(c) gives support to shareholder resolutions where these reflect concerns which are shared and represent the Fund interest*

*(d) joins wider lobbying activities where appropriate opportunities arise.*

# Pensions CIV Sectoral Joint Committee Item no: 9

## Passive Funds Fee Proposal

| | | | |
|---|---|---|---|
| **Report by:** | Hugh Grover | **Job title:** | Chief Executive, London CIV |
| **Date:** | 8 February 2017 | | |
| **Telephone:** | 020 7934 9942 | **Email:** | hugh.grover@londonciv.gov.uk |


**Summary:**

In 2015 and 2016, London CIV was instrumental in negotiating a substantial reduction of management fees across the London Local Authority (LLA) passive assets managed by Legal and General (LGEM)

London CIV was asked to consider options for charging a fee to London Local Authorities (LLAs) on passive funds held outside of LCIV which have benefitted from LCIV fee negotiation efforts.

This report informs Committee members on the negotiations background, passive fee options and LCIVs proposal for the fee structure and fee level to be implemented as of 1st April 2017.


**Recommendations:**

The committee is recommended to:

(i) Agree an AUM based fee to be charged to the LLAs benefitting from reduced fees negotiated by LCIV on any passive funds managed outside of LCIV;

(ii) Consider the fee level options in Annex B and agree preferred fee scale to be charged; and

(iii) Agree date of 1st April 2017 for implementation of passive fee charges to commence and a review of the fees after five years.

(iv) Agree that LLA's investing in passives funds where reduced fees have been negotiated by LCIV are charged from the first full month after subscribing to the passive fund

# Passive Funds Fee Proposal

## Introduction

1. Over a period of several months in 2015 and 2016, LCIV engaged with the London Local Authorities' (LLA) passive fund providers including Legal and General Investment Management (LGIM) and Blackrock Asset Management to create an opportunity for LCIV to hold the LLA passive assets on the LCIV Authorised Collective Scheme (ACS).

2. Through a number of conversations with both LGIM and Blackrock and discussions of a of possible models and implementation requirements, it became clear in the first half of 2016 that moving the passive assets into LCIV would be both extremely complex and expensive. This result, coupled with the Government announcement that Life Funds could be held outside of the Pools (an announcement at odds with its previous position), led LCIV to focus on negotiating fee reductions with LGIM whilst the LLAs continued to hold existing life policies. This would deliver benefits to the LLA's from mid-2016 and allow resources at LCIV to focus on other key projects to deliver wider benefits to investors.

3. Discussions with BlackRock have also been ongoing and LCIV facilitated a session in October where proposals were presented to investing LLA's by BlackRock. These proposals are currently being reviewed, with further discussions taking place over the next few weeks. It is hoped that options which deliver savings benefits to those investors will be agreed soon.

4. The LGIM negotiations concluded in August 2016 resulting in substantial reductions being applied to existing LLA policies across both equity and fixed income assets. The aggregated annualised savings across the LLAs amounted to £1.8 Mn with the fee reduction backdated to 1st July 2016.

5. A view has been put forward to LCIV that a substantial amount of work and cost (including legal advice) was undertaken on behalf of the LLAs invested in LGIM and that, although the assets are not held inside the CIV, the time and cost to achieve the fee reductions should be offset by a charge to LLAs benefitting from the fee savings. This view has been expressed by a number of LLAs, some of whom are and are not invested with LGIM.

6. To address this view, LCIV was asked to consider potential passive fee options and provide a proposal for consideration by the LLAs for implementation in financial year 2017/18. The following provides a summary of the fee options, selection criteria, fee levels and LCIVs recommended fee structure.

7. It should be noted that, in addition to the Government announcing that Life Funds could be held outside of the Pools, the Government also said "it is expected that the management and reporting regarding these life funds is done within the pool".. LCIV has not yet assessed either the requirements or potential costs of this management and reporting process. If the required process introduces substantial costs, LCIV may need to discuss potential adjustments to the passive fee levels to cover these additional costs.

8. LCIV have been and continue to work closely with the 2 main passive providers in London to monitor developments and to ensure that future opportunities in the passive arena are made available to LLA's at agreed fee rates. In addition LCIV is working closely with LGIM on voting issues, notifying LGIM of any LAPFF voting alerts and receiving confirmation of votes undertaken on behalf of London Funds. These are being reported to the PSJC along with the existing sub-fund manager voting.

**Passive Fee Options**

9. LCIV has considered a range of options for charging a passive fee. The three key options assessed by LCIV include and are outlined in more detail in Annex A:

   i. **Assets under Management (AUM)**. A basis point (bp) fee based on the level of the individual LLAs passive assets AUM.

   ii. **Percent of fee savings.** A fee based on a percent of the individual LLAs annual fee savings on passive assets experienced by individual LLAs.

   iii. **Flat fee.** A flat fee to be charged equally to all LLAs

**Selection Criteria**

10. In assessing the above fee structures and fee levels, LCIV applied the following criteria:

   i. **Fairness**. As part of the LCIV charging principles and a priority of the LLAs, the fees should be fair and LLAs should not be charged disproportionately

   ii. **Implementation**. The data requirements, reporting and invoicing processes, and fee structure should be relatively simple for both the LLAs and LCIV to implement and not add substantial operational complexity or cost for the LLAs or LCIV

   iii. **Net Benefits**. All LLAs should continue to have a net benefit after the fee is applied.

11. A summary of the fee options in paragraph 8 and assessment can be found in Annex A.

**Passive Fee Structure Proposal**

12. LCIV believes that option (i) in paragraph 8 above, a fee based on AUM, is the most viable option and proposes this option for adoption by the Committee. The fee would be calculated on each LLAs passive assets AUM at the end of each month and invoiced annually at the end of each financial year.

13. In addition, LCIV has considered the basis point fee levels of a quarter bp (0.0025%) and a half bp (0.005%). A summary of the potential fees per LLA based these potential bp level and AUM as of 31st December 2016 can be found in Annex B. The Committee is asked to consider the fee level options in Annex B and provide guidance to LCIV of the preferred approach.

14. The recommendations and agreed approach will then be put to the Board of LCIV for final agreement prior to implementation.

**Recommendations**

15. The Committee is recommended to:

    i. Adopt an AUM based fee to be charged to the LLAs benefitting from reduced fees negotiated by LCIV on any passive funds managed outside of LCIV

    ii. Consider the fee level options in Annex B and agree preferred fee scale to be charged; and

    iii. Agree date of 1st April 2017 for implementation of passive fee charges to commence and a review of the fees after five years.

    iv. Agree that LLA’s investing in passives funds where reduced fees have been negotiated by LCIV are charged from the first full month after subscribing to the passive fund

**Financial implications**

16. The new passive fee would impact LLAs benefiting from the LGIM fee reductions as outlined in Annex B.

**Legal implications**

17. Implementation of the passive fund fee will require a data sharing arrangement to be put into place between the LLAs, LCIV and passive fund managers

**Equalities implications**

18. There are no equalities implications for London Councils.

**Annexes**

Annex A: Summary of fee options and assessment

Annex B: Illustration of potential fees to be charged to LLAs based on basis point levels.

**ANNEX A**

## PASSIVE FEE STRUCTURE OPTIONS AND ASSESSMENT

| Option | Description | Pros | Cons |
|---|---|---|---|
| **OPTION 1**<br><br>*Fee based on AUM of LLA passive funds* | Fee charged based on agreed basis point level on AUM of passive funds managed outside LCIV which have benefitted LCIV fee negotiations<br><br>Fee to be calculated on month end AUM per LLA and invoice annually | • Fairness: Aligns with fairness approach as those boroughs paying fee benefitted from LCIV's negotiations<br><br>• Fairness: AUM based fee ensures LLAs with smaller AUM are not negatively impacted<br><br>• Implementation: Based on industry standard approach basis point charging approach | • Implementation: Requires L&G monthly charging report to be developed<br><br>• Fairness: Does not take into consideration the net fee savings per LLA as some LLAs with higher AUM had smaller fee savings |
| **OPTION 2**<br><br>*Fee based on % of LLA annual savings* | Fee charged as a percent of LLA's annual savings on passive funds managed outside LCIV benefitting from LCIV fee negotiations | • Fairness: Aligns with fairness approach as those boroughs paying fee benefitted from LCIV's negotiations<br><br>• Fairness: Savings based charge ensures those who have smaller annual savings are not negatively impacted | • Implementation: Complex charging structure introduction accounting complexities for LLAs and LCIV and requires annual agreement on fee savings per annum<br><br>• Implementation: Base of fee savings calculations would need to be completed annually on each type of passive fund and agreed with the LLAs<br><br>• Implementation: New LLA investors would have no basis to calculate fee savings and a base savings level would need to be agreed |
| **OPTION 3**<br><br>*Flat fee* | Flat fee charged annually to LLAs invested in passive funds managed outside LCIV benefitting from LCIV fee negotiations | • Fairness: Aligns with fairness approach as all LLAs pay the same fee and LLAs paying fee benefitted from LCIV's negotiations<br><br>• Implementation: Simple fee structure | • Fairness: Does not take into consideration the relative levels of AUM level or annual savings across LLAs |

**ANNEX B**

# POTENTIAL FEE CHARGES

**Summary of potential passive fund fees per London Local Authority (LLA)**

| # | London Local Authority | AUM as of 31st Dec 2016 (£) [1] | LGIM June 2016 Estimated Annualised Gross Fee Savings based on AUM (£) | Basis Point Charge (£) 0.0025% | Basis Point Charge (£) 0.0050% |
|---|---|---|---|---|---|
| 1 | Royal Borough of Kensington and Chelsea | 276,220,962 | 235,139 | 6,906 | 13,811 |
| 2 | London Borough of Haringey | 1,000,243,022 | 165,334 | 25,006 | 50,012 |
| 3 | London Borough of Newham | 325,181,909 | 149,731 | 8,130 | 16,259 |
| 4 | London Borough of Southwark | 394,131,820 | 224,207 | 9,853 | 19,707 |
| 5 | London Borough of Richmond upon Thames | 303,361,980 | 183,706 | 7,584 | 15,168 |
| 6 | London Borough of Brent | 356,150,416 | 186,434 | 8,904 | 17,808 |
| 7 | London Borough of Barnet | 415,846,755 | 171,723 | 10,396 | 20,792 |
| 8 | London Borough of Camden | 504,135,796 | 143,812 | 12,603 | 25,207 |
| 9 | London Borough of Hammersmith and Fulham | 278,621,582 | 198,179 | 6,966 | 13,931 |
| 10 | London Borough of Islington | 90,303,711 | 77,933 | 2,258 | 4,515 |
| 11 | Westminster City Council | 267,741,961 | 181,220 | 6,694 | 13,387 |
| 12 | London Borough of Sutton | 68,409,216 | 23,194 | 1,710 | 3,420 |
| 13 | London Borough of Tower Hamlets | 327,812,128 | 83,787 | 8,195 | 16,391 |
| 14 | London Borough of Croydon [2] | 535,574,667 | | 13,389 | 26,779 |
| | *Total* | 5,143,735,923 | 2,024,397 | 128,593 | 257,187 |
| | *Potential Fee as a percent of total annualised fee savings of £2 Mn* | | | 6% | 13% |

[1] AUM based on LGIM report of AUM value per LLA as of 31st December 2016

[2] Croydon outside scope of fee savings due to nature of mandate being outside of main Life Funds in a segregated account.

*Note: Where additional Funds invest and receive the lower LCIV rate card, they will also receive a fee charge from first full month of investing*

# Pensions CIV Sectoral Joint Committee

Item no: 10

## Markets in Financial Instruments Directive 2 (MiFID2)


| | | | |
|---|---|---|---|
| **Report by:** | Hugh Grover | **Job title:** | Chief Executive, London CIV |
| **Date:** | 8 February 2017 | | |
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**Summary:**

**Recommendations:** The committee is recommended to consider and discuss the contents of this report.

# Markets in Financial Instruments Directive 2 (MiFID2)

## Background

1. MiFID2 is the European Union's second Markets in Financial Instruments Directive. The original version of MiFID (MiFID1) established a pan European framework for the provision of investment services and the operation of markets. It has been in force since November 2007.

2. The existing MiFID1 framework is being substantially amended via legislation published in 2014, which splits MiFID1 into two parts. First, there is a "recast" MiFID1 (commonly referred to as "MiFID2") dealing primarily with authorisation, systems and conduct requirements in relation to investment business. Second, there is a Markets in Financial Instruments Regulation ("MiFIR") dealing with transparency, transaction reporting, clearing, and supervision of positions.

3. MiFID2 and MiFIR significantly increase the scope of MiFID1, in part, as a response to the financial crisis. Other key catalysts for the proposed revisions include: (i) technological developments, particularly around algorithmic trading and direct market access systems; (ii) perceived weaknesses in transparency in relation to investments other than shares; and (iii) a desire to enhance investor protection.

4. MiFID2 was planned for implementation from January 2017 but that has been deferred until January 2018.

5. The committee last discussed the impact of MiFID2 at its meeting of 4 November 2015 when representatives of the Financial Conduct Authority (FCA) and HM Treasury were in attendance.

## Impact

6. The most significant impact for UK local government is the complete downgrading of local authorities from "professional" to "retail" investor status. This is in response to examples of poor investment decisions by local authorities across Europe and a desire on the part of European regulators to 'protect' such authorities from riskier investment options available in the markets. The FCA has no scope to dis-apply this change in the UK.

7. While the impact on treasury management will fall across the whole of the EU, and indeed was the target area for the directive, the impact on pensions will only prevail in the UK as no other EU country has its local government pension arrangements directly linked to its local authorities. It seems likely that the regulators had no awareness of the LGPS and that the impact is an entirely unintended consequence.

8. The effect will be that all financial services firms like banks, brokers, advisers and fund managers will have to treat local authorities in the same way as they do individuals and small businesses. That includes ensuring that investment products are suitable for the customer's needs (potentially closing the option for the LGPS to invest in certain products), and that all the risks and features have been fully explained. This involves significantly more paperwork for both the firm and the client, to prove to the regulator that all the steps have been taken, and as evidence in case of alleged miss-selling.

9. MiFID2 includes an option for certain retail clients to opt for professional status ("Elective Professional Client" status) and this option would be available to local authorities in the UK. As things currently stand opting up would need to be done with each fund manager and in each asset class, and separately for treasury management and LGPS purposes.

10. The FCA published a consultation in September 2016 (https://www.fca.org.uk/publications/consultation-papers/cp16-29-mifid-ii-implementation) which set out their proposals for the opt-up regime that would apply to UK local government. London CIV responded to the consultation and a copy of the submission is attached for information.

11. The regime has a qualitative element and a quantitative element. In the consultation these two elements were defined as:

- **Qualitative test:** the firm [fund manager] undertakes an adequate assessment of the expertise, experience and knowledge of the client that gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved;

- **Quantitative test:** criteria (a) and either criteria (b) or (c) must be satisfied:

  (a) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds £15,000,000

  (b) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters

  (c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged

12. The qualitative test would appear to allow some scope for interpretation by each individual fund manager, but is specific to the "…nature of the transactions or services envisaged" which would suggest that the individual at each authority will need to have a very broad based background to open up the full range of asset classes that would be required for a LGPS fund.

13. On the quantitative test; every LGPS fund would pass criteria (a), however, it seems very unlikely that any pension fund would pass criteria (b) as it would require an exceptional scale of churning across all asset classes. It may be that some funds could pass criteria (c) but that would depend on having a Member or Officer with the requisite work experience and, again, it would appear to be required across all asset classes.

**Conclusion**

14. It remains to be seen how the final opt-up criteria will be framed, but as things stand the impact on LGPS funds could be disastrous. The range of investment options could be severely curtailed and the government's desire for the LGPS to invest more in infrastructure entirely undermined.

15. Officers of London CIV and the wider LGPS community (under the leadership of the LGA) are engaged in on-going discussion with the FCA with a view to developing a workable solution.

**Recommendations**

16. The committee is recommended to consider and discuss the contents of this report.

**Legal Implications**

17. Legal implications as currently known are contained in the body of this report.

**Financial implications**

18. Financial implications as currently known are contained in the body of this report.

**Equalities Implications**

19. There are no equalities implications for London Councils

**Attachments**

20. London CIV response to the FCA's MiFID2 consultation

## FCA: MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE II IMPLEMENTATION – CONSULTATION PAPER III

### London CIV Response to the Reclassification of Local Authorities as Retail Investors

### Question 16: Do you agree with our approach to revise the quantitative thresholds as part of the opt-up criteria for local authorities by introducing a mandatory portfolio size requirement of £15m? If not, what do you believe is the appropriate minimum portfolio size requirement and why?

London LGPS CIV Limited ("London CIV") is fully authorised by the FCA as an Alternative Investment Fund Manager (AIFM) with permission to operate a UK based Authorised Contractual Scheme fund (ACS Fund).

Approval for the structure has been signed off by the 33 participating London Local Authorities with each authority formally approving the decision to join the London CIV. The London CIV was formed as a voluntary collaborative venture by the London Local Authorities in 2014 and has led the way in pooling of investments in the LGPS. London Local authorities and their pension funds have been working together for over 3 years to bring the benefits of pooling of investments in London.

In considering the FCA consultation on the implementation of MiFID II, the London CIV would like to register its concerns on the reclassification of Local Authorities as retail investors and in particular as this relates to the Pension Funds administered by those authorities. We do not believe that the quantitative criteria as proposed by the FCA is appropriate for Local Authority Pension Funds, which whilst the size criteria would not be an issue (Pension Funds in London range between £506m to £1.25bn), the transactions and financial sector experience as relating to individuals would cause London Funds a problem in terms of being able to opt-up to professional status. We are extremely concerned about the impact the proposed quantitative tests would have on both our clients (London LGPS Funds) and ourselves as the Investment Pool of choice for London LGPS Funds.

We have reviewed responses to the consultation from the LGPS Scheme Advisory Board, the Local Government Association and the Pensions and Lifetime Savings Association and would like to endorse the comments provided within those responses in addition to providing our own comments below.

- Whilst recognising that the FCA are consulting on the implementation of the directive rather than on the directive itself, we believe that the reclassification of Local Authorities, particularly in relation to the Pension Funds, as retail investors is unnecessary given the breadth and depth of experience in managing these Funds and will add significant complexity to the management of these Funds at a time when other significant regulatory changes are underway.

- Local Authority Pension Funds have considerable regulatory requirements which ensure appropriate levels of governance and decision making is in place with requirements to seek ‘proper advice’ before making investment decisions. They are required to set out their Funding Strategies and Investment Strategy Statements, along with full financial disclosures and as such meet high exacting financial and regulatory standards and it seems at odds that they are now to be classified as retail investors. This is especially so when considered against other defined benefit pension schemes which are likely to retain professional status despite in many cases being smaller in assets under management and possibly with less scrutiny than many of the LGPS Funds that face constant public scrutiny.

- The London CIV as an FCA Regulated AIFM is likely to face significant challenges in trying to assess all London Funds suitability for investing in a wide range of investments, particularly at a time when the Government is pressing the London CIV and other LGPS Pools to deliver pooling of investments within relatively short timeframes given the requirements for pools of £25bn plus. As the largest of the LGPS Pools by number of participants, the London CIV will face considerable pressure in assessing each of the now 32 (following the merger of 2 Funds) investing funds, as it is our understanding as a Fund Manager we will be required to undertake these assessments to ensure they meet the opt up criteria. The timing of such assessments coinciding with the Government’s requirement for Funds to transition liquid assets into their designated Pools will add considerably to the financial and administrative burdens of pooling.

- The need to undertake the elective professional status will have operational cost implications for both the individual Pension Funds and the Collective Investment Schemes set up by LGPS Funds to comply with HM Government’s mandated pooling agenda.

- Whilst all Funds in London are able to meet the scale criteria in the Quantitative Test being proposed of £15m, we do not believe that any will be able to meet the transactional criteria of an average of 10% per quarter over the previous four quarters. Indeed this again seems at odds with the nature of long term defined benefit pension schemes, who need to set long term strategies to meet their liabilities and such levels of transactional turnover, would run counter to the normal good governance practices of long term pension schemes.

- The alternative quantitative test to the transactions test is to assess whether the client has worked in the financial sector for at least one year in a professional position again posses considerable challenges given the nature of decision making in local authorities. In the majority of LGPS Funds, the decision making is undertaken by a Committee acting on behalf of the Administering Authority of the Pension Fund, rather than an individual. We would request that should this test remain, then amendments should be included to incorporate for decision making structures of local authorities.

- One of the objectives of pooling is to provide improved access to a wider range of investment opportunities that are more difficult for smaller funds including investments such as direct property and infrastructure, the reclassification of LGPS Funds will make this more protracted at a time when government policy is encouraging funds to invest in infrastructure. We would like here to support the proposals put forward by the Scheme Advisory Board response: "We therefore request that FCA ensure that asset pools can provide an effective point of access for local authority pension funds, in line Government policy objectives, by listing them as an exemption in their own right. This would result in local authorities being able to invest in a full range of assets via Collective Investment Schemes without having to undergo an elective process." This would certainly have the effect of ensuring that where the Pools are able to provide wide ranging investments, the Funds would be able to invest through the Pool in the same way as they would have done with professional status.

- Assuming that the reclassification to retail status proceeds for Local Authorities and by default their Pension Funds, the move to retail client status on 3rd January 2018 will cause issues for some of our investing authorities where longer term commitments are in place, particularly as they relate to alternative asset classes. Even if the London CIV were provided exemption status, we would not be in a position to pool some of the investments that Funds currently have that would otherwise require successful election to professional status, leaving them and their providers with considerable uncertainty over the status of these investments and possible forced sellers. We would request that consideration be given to allowing any investments made prior to January 2018 be exempted until such time as either authorities are able to successfully opt up to professional status or the London CIV and other Pools are in a position to make arrangements for the pooling of such investments where appropriate to do so.

# Pensions CIV Sectoral Joint Committee

Item no: 11

## London CIV Governance Review

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|---|---|---|---|
| **Report by:** | Hugh Grover | **Job title:** | Chief Executive, London CIV |
| **Date:** | 8 February 2017 | | |
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**Summary:** At its meeting of 13 December 2016 the committee considered a report from London Councils covering constitutional matters associated with this Sectoral Joint Committee. This report provides a further update to Members and proposals for taking forward a wider governance review of all the arrangements pertaining to London CIV and the participating London local authorities, before making any changes that would have a direct impact on this committee.


**Recommendations:** The committee is recommended to consider and discuss the contents of this report.

# London CIV Governance Review

## Background

1. At its meeting of 13 December 2016 the committee considered a report from London Councils covering constitutional matters associated with this Sectoral Joint Committee and its dissolution (see Background Papers below).

2. Following that meeting, and in light of some of the concerns expressed further discussions have been had with the London Councils' Chair, Group Leaders and Chief Executive, the Chair and Group Leaders of this committee, and a range of stakeholders, including Treasurers from the Investment Advisory Committee (IAC). Those discussions have led to the decision that a wider governance review should be commissioned that will encompass all the governance arrangements pertaining to London CIV and the participating London local authorities (LLAs) before making any changes.

## Proposal

3. The governance arrangements for LCIV and the participating LLAs were developed at an early stage and in the context of LLA participation at all levels being entirely voluntary. The government's intervention in terms of requiring all LGPS funds to enter into pooling arrangements has changed the environment to a more mandatory position. With that in mind, and because LCIV has completed its first year of operating it is proposed to commission a governance review that will cover arrangements both inside and outside the organisation.

4. In broad terms the aim of such a review will be to ensure that the overall governance structure is fit for purpose, and structured to ensure the right levels of control, decision making, and oversight both now and into the future.

5. LCIV's Board is fully committed to the review and has been consulting with the IAC Treasurers to draft the terms of reference and scope which is attached for consideration by Members. Subject to the views of Members a search and selection will be undertaken to find a suitable organisation (or suitably qualified individuals) to undertake the work. The aim will be to have a final report ready for consideration ahead of the summer recess.

6. Members will wish to note that the terms of reference and scope were put to London Councils' Leaders Committee on 7 February 2017 and any material outcomes of that meeting will be reported to this meeting by the Chair.

## Recommendations

7. The committee is recommended to consider and discuss the contents of this report.

## Legal Implications

8. There are no legal implications at this time.

## Financial implications

9. There will be a cost associated to commissioning the governance review, it is not clear at this time precisely what that cost will be but the selection of a suitable

organisation (or suitably qualified individuals) will be done through a procurement exercise to ensure value for money.

**Equalities Implications**

10. There are no equalities implications for London Councils

**Attachments**

11. London CIV Governance Review Terms of Reference and Scope

**Background Papers**

Report to 13 December 2016 Pensions CIV Sectoral Joint Committee; Item 6, Constitutional Matters http://www.londoncouncils.gov.uk/node/30892

# London CIV Governance Review

## Terms of Reference and Scope

### Background

London CIV (LCIV) was launched in December 2015 to be the operator of the London Local Government Pension Scheme (LGPS) pool, bringing together (over time) the pension fund assets of the 32 London boroughs and the City of London Corporation.

Originally the pooling arrangements were being set up on an entirely voluntary basis, with the level of commitment and investment resting entirely with each pension fund. However, in November 2015 the government published criteria and guidance that has changed the environment to one of mandatory pooling. The CIV has also reached full membership of all 33 London LGPS funds and consequently has to review the parts of its governance arrangements that relate to the London Councils' Sectoral Joint Committee that was established to provide democratic oversight of the pooling arrangements and acts as the forum for convening shareholder representatives at General Meetings of the company. It therefore makes sense to undertake a governance review, even though the arrangements have only been in place for a relatively short period of time.

The review is being commissioned by LCIV's Board with full engagement and consultation through London Councils' Leaders' Committee, the Sectoral Joint Committee and with representative borough Treasurers. The final report will be shared with those same groups for review and discussion, and to inform decisions about what changes to the current arrangements may be required.

### Purpose

Consider the governance structures associated with the Pooling arrangements for the London LGPS funds as currently undertaken through LCIV arrangements, recommending potential improvements to ensure that all stakeholders have the necessary and appropriate level of engagement and influence, and that decision making is correctly positioned and defined. This should take into account the fiduciary, regulatory and statutory responsibilities of LCIV, its directors and officers, and the investing LGPS funds, including the impact of MiFID II on the investment status of local government.

Any proposals for change should recognise the stage of development that LCIV has reached (i.e. passing through start-up phase and heading towards business as usual) and should ensure that existing and any proposed structures are future proof and represent the most economic, efficient and effective use of scarce public sector resources.

Reference should also be had to the emerging structures in other LGPS pools with a view to determining whether there are any points of best practice that could be incorporated into any amended structure

### Scope

1. Review roles and responsibilities and comment on the overall governance structure of LCIV in the context of its purpose, the requirements and needs of the investing LGPS funds, the government's policy on the pooling of LGPS funds, and the regulatory regime imposed by the FCA.

2. Review and comment on LCIV's committee structures, roles and responsibilities, terms of reference and composition (including the requisite skills, knowledge and training programmes) for the:
    - Board;
    - Executive Committee;
    - Investment Oversight Committee;
    - Compliance, Audit & Risk Committee; and
    - Remuneration Committee.

    to include documentation of key decisions.

3. Review, roles and responsibilities and comment on the committee structures that sit outside of LCIV, including terms of reference and composition (including the requisite skills, knowledge and training programmes) for the:
    - London Councils' Pensions CIV Sectoral Joint Committee;
    - Investment Advisory Committee

4. Review roles and responsibilities, as defined by regulations, of:
    - London local authority pension Committees
    - London local authority Treasurers
    - London local authority Pension Boards

**Stakeholders**

Key stakeholders and groups of stakeholders are:

- London CIV directors and staff
- London Councils' Pensions CIV Sectoral Joint Committee
- London local authority Treasurers (AKA Section 151 Officers or the Society of London Treasurers)
- London local authority Pension Committees (or equivalent)
- London local authority Pension Boards
- London local authority Pension Fund Managers (or equivalent)
- Central government (i.e. DCLG and HM Treasury)
- The Financial Conduct Authority

**Reference Material**

Key reference material includes:

- DCLG, November 2015; Local government pension scheme: investment reform criteria and guidance
- DCLG, November 2015; Design of the structure and governance of efficient and effective collective investment vehicles for LGPS Funds
- CIPFA, Investment Pooling Governance Principles
- LGPS regulations
- Financial Services regulations and the FCA handbook
- Shareholders Agreement
- Articles of Association
- LCIV Business Plan 2017-20
- Relevant LCIV policies, including those for the appointment, oversight and management, and firing of 3rd party Fund Managers