Local Government Pension Scheme pooling: progress report

Please report against each of the areas outlined below as at 31 March 2017, highlighting significant changes since your final proposal.

The deadline for submission is Friday 21 April 2017. We will follow up any questions or concerns with individual pools as necessary.

Pool:__London CIV____________________________

Date:___April 2017___________________________

Criterion A: Scale

For pools in development

- Scale – please state the estimated total value of assets included in your transition plan for investment through the pool structure, with date of estimate
- Assets outside the pool - please state the estimated total value of assets to be invested outside of the pool structure by participating funds
- Progress towards go live by April 2018
  - please provide an updated high level project plan to achieve delivery by April 2018 including progress with operator procurement/build, design of sub funds, recruitment of core team, appointment of depository and FCA authorisation
  - please identify risks or issues which may delay delivery by April 2018, and any plans to mitigate risks and/or manage issues

For operational pools

- Structure and scale - please state the total value of assets to be invested via the pool together with the value of assets to be invested outside of the pool by participating funds
- Progress with transition - please state the value of assets within the pool and provide an updated high level transition plan

LCIV Response

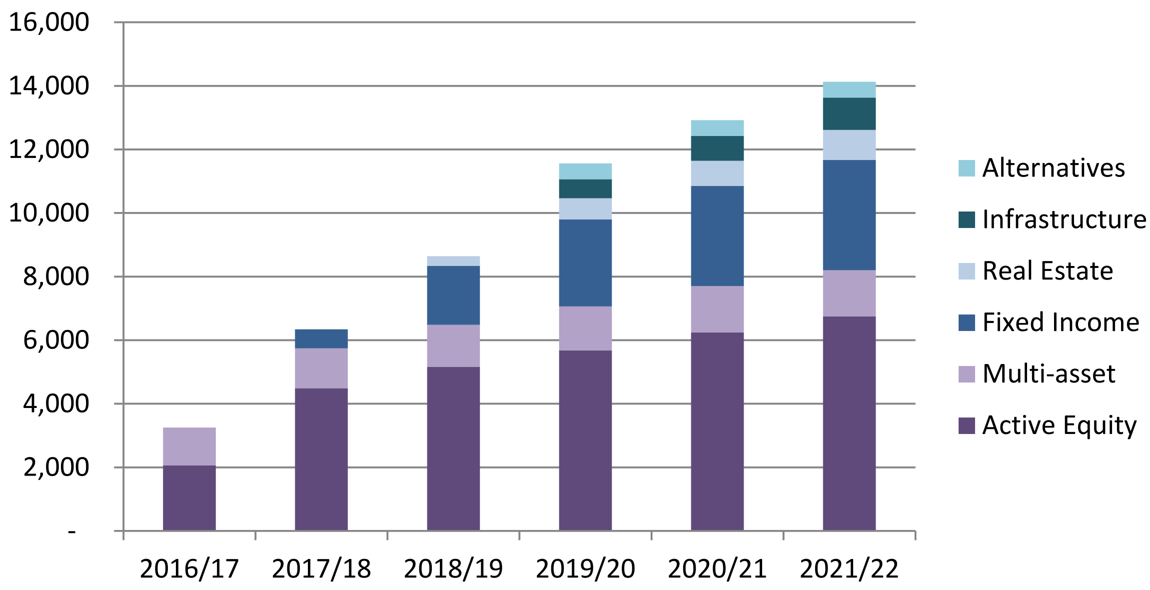
- As at 31/03/17 assets under management within London CIV were £3.5bn with 18 London Local Authorities (LLA) invested. LLA refers to the 32 London Boroughs and the City of London Corporation. Following the merger of the London Borough of Wandsworth and London Borough of Richmond Pension Funds, there are now a total of 32 LLA Pension Funds. Annex A shows the current sub-funds available to LLA's and the number of funds invested in each.
- An additional 3 sub-funds based on a commonality, quantum and conviction approach (i.e. existing LLA mandates) are in the process of being opened which will see the transition of a further estimated £1.6bn-£1.8bn AUM and will bring on board another 2-3 LLAs.
- Following a global equity procurement exercise undertaken in 2016, an initial 3 global equity managers have been selected for the next 3 sub-funds to be opened in July and September. The 3 investment strategy sub-funds comprise Emerging Markets (July), Global Equity Income and Sustainable

Equities (September), these have been selected as a first stage following an assessment of LLA requirements for additional global equity options. A global equity information day is being held on 11th May following which, LCIV anticipates being able to update with further specific investment levels for each fund from the LLA's although it is recognised that it may take some time for assets to be transitioned as LLA's continue with their strategic asset allocation evaluations.

- Over the summer, additional work will be undertaken with the LLAs to determine the level of demand for additional global equity investment strategies. Additional managers have been shortlisted to fulfil a range of investment strategies to make them available for sub-fund launches in December.
- In addition London CIV has successfully negotiated London wide CIV rate lower fee scales with 2 passive life fund providers which covers an additional £7.2bn AUM. At this time, life funds will remain outside the LCIV pool as per the government's asset exemptions:

  > "Pools may therefore continue to hold existing life funds in the name of the current insured party but it is expected that the management and reporting regarding these life funds is done within the pool."
- LCIV is working closely with the passive life fund providers to fulfil the expectation that the pool will manage and monitor the life funds and is now receiving quarterly reporting from one of the managers where agreement on fees was reached in mid-2016. In addition, in recognition of the savings delivered and the additional monitoring required by LCIV, the Pensions Sectoral Joint Committee agreed at it's meeting in February proposals that LCIV could apply an asset under management based fee on passive assets where LCIV had negotiated and agreed London wide fee rates with passive life fund providers.
- At the time of the July 2016 submission, based on 31 March 2015 data, approximately 26% of LLA's assets were in passive life funds, whilst data to end March 2017 is not yet available for comparative purposes, LCIV believes that as a percentage of assets across London Funds, this is unlikely to have significantly changed and therefore will continue to remain outside of the Pool for the foreseeable future.
- Further, at the time of July 2016 submission assets to be held outside the pool in the medium term included assets such as private equity , property and Fund cash and amount to £4.5bn. This was in addition to the £7.5bn held in passive life funds. Consequently, approximately £12bn was likely to remain outside of the LCIV pool or just over 40% of the assets across the LLAs. At the time of writing, LCIV is currently working closely with the LLAs to assess their strategic asset allocations following the triennial actuarial valuation to better understand how asset allocations might change over the next 1-3 years in order to assess the potential impact on the level of assets to be held outside of LCIV.
- The February meeting of the Pensions Sectoral Joint Committee considered LCIV's updated business plan and medium term financial strategy http://www.londoncouncils.gov.uk/node/31261 The business plan and MTFS set out the programme for launch of sub-funds and an estimate of the timeframe over which assets would transition across to LCIV. Based on the transition plans within the business plan, LCIV forecast £14.2bn

assets under management by March 2022, and that under more optimistic assumptions assets under management by LCIV could increase to £19.4bn if LLA's transition at a faster pace than currently forecast in the base case. The table below shows the progression of asset transfer into LCIV:



- Based on the 2015 assets under management held across LLAs on which LCIV were required to submit proposals on, the table below provides the level of assets transferred in each asset class on the base scenario.

	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%

Criterion B: Governance

For pools in development

- Progress with governance arrangements - please provide an updated high level project plan for the implementation of governance arrangements.

For operational pools

- Changes to governance since final proposal - briefly describe any changes to the governance structure, in particular please set out your plans for ensuring the pool can effectively implement the asset allocation and responsible investment strategy of each fund

LCIV Response

- There have at the time of responding to this progress report been no changes to the governance structure. London CIV is currently commissioning a governance review to ensure that the structures and decision making processes in place are robust and effective. Government will recognise that London CIV pool has been operational for some time and was established in advance of the Government's Criteria and Guidance requirements.
- An update on the progress of the governance review will be provided in the October report
- Government will be aware that the LCIV Pool is in some ways more complex than the other pools, despite commencing pooling at an earlier stage; due to the larger number of participating local authorities, at over 2½x the next largest pool for authorities and having started very much on a voluntary basis. Collating and understanding the 32 strategic investment plans is and will continue to be a resource intensive process, particularly given the typically lower level of resources internally at the local authorities dedicated to managing the pension funds.
- LCIV is currently working closely with the participating authorities to develop a fuller picture of the changes which are likely to be effective following the 2016 actuarial valuation as this is likely to impact on future requirements and it may be necessary to adopt a more flexile approach to the business plan if LCIV is going to be able to more effectively offer solutions for LLA Pension Funds to be able to implement their updated asset allocations.
- It should also be recognised that the strategic asset allocation requirements across London Funds, by the very nature of the number of Funds are also in very different places from a funding and cashflow perspective giving rise to significant variations in requirements from the perspective of strategy. Of all the Pools, London undoubtedly has the widest dispersion in terms of funding levels and cashflow requirements. As can be seen from the published results from the actuarial valuations, funding levels vary between less than 60% to over 100% and cashflows before investment income vary considerably, with an increasing proportion of Funds being cashflow negative, but with others remaining strongly cashflow positive. This leads to very different strategic investment requirements and asset allocations.
- Given the regulated structure under which LCIV currently operates as an AIFMD and in particular the ACS structure, it has to be recognised that implementation takes time to achieve once decisions on sub-funds have been agreed. Legal, regulatory and operational clearance takes time and LCIV are cognoscente of the fact that as other pools become operational and pressures on external suppliers intensify to meet deadlines for other pools this could further slowdown the ability of LCIV to potentially meet the deadlines set out in its business plan and MTFS.
- Like a number of other Pools, LCIV has signed up to be a founder member of the National LGPS Transition Manager Frameworks, this will enable competitive pricing and swifter access to transition managers as and when required for LLAs looking to move assets across to LCIV.
- With regards to the responsible investment strategy of LLA's, the regulations make it clear that it is for the Fund to determine it's individual approach to ESG matters and voting and is required to set out their policy in the

Investment Strategy Statement for the Fund. LCIV are currently reviewing all the ISS across the LLA's to assess requirements. However, working groups at both Member and officer level have been established to look at the whole area of Stewardship and how this can best be approached by LCIV. LCIV worked closely with these groups to agree an approach for LCIV to meet the requirements of the FRC Stewardship Code and the LCIV Compliance Statement and the FRC has confirmed that the Statement meets the requirements of a Tier One as an asset owner, the Statement can be found: https://www.frc.org.uk/FRC-Documents/Corporate-Governance/Stewardship-Code/London-CIV.pdf

- LCIV recognises that across the 32 LLAs Pension Funds, very different views and policies on ESG and voting are in place and that it is unlikely to be able to meet all these requirements, but is keen to work closely with authorities to reach some areas of common ground hence the importance of the Stewardship working groups.

Criterion C: Reduced costs and value for money

For all pools

- Update on costs/savings estimates – please state current high level estimates for implementation costs and eventual annual savings
- Plans for delivering savings – please set out your high level plan and timescales for delivering the annual savings above
- Plans for reporting including on fees and net performance in each listed asset class against an index – In particular please set out how the pool will report fees to participating funds on a fully transparent basis and using comparative performance and/or cost data.

LCIV Response

- Estimated annualised savings from the sub-funds which are already open amount to £1.38m, with further estimated annualised savings of £2.16m to come through from the additional 3 sub-funds being opened on the basis of existing funds being transitioned to the LCIV platform.
- Estimated annualised net savings from passive fees negotiations and implemented amount to £1.76m. Further annualised fee savings from passive life funds are expected as a second mainstream provider has now agreed terms for London CIV funds which will deliver further annualised savings of just under £1m on the basis of current assets under management.
- Increasingly as the CIV moves forwards, direct comparisons on fee savings will become more difficult as new managers are procured rather than directly transitioned from existing mandates. However, as part of the global equity procurement exercise, managers were asked to evidence in their tender submissions the fee scales for standard institutional mandates versus the fees that would be charged on the new CIV mandates should the provider be successful in their tender submission. Whilst potential fees savings did vary considerably across the different strategies and structures, significant discounts on standard fees were offered across the board. As assets transfer to the new sub-funds, the notional savings on investments will be calculated

as assets move across on to the CIV platform to provide evidence on the benefits of scale moving forwards.

- Taking into account the assets under management on the CIV platform and those due to transition across in the next 3 months along with life funds where fee negotiations have been agreed, assets under management or in passive on the CIV platform amount to around £12bn or just over 42% of assets that were reflected in the July submission relating to AUM at 31/03/15. Annualised fee savings including those due to transition shortly and in passive life funds amount to an annualised savings of around £6.3m. At the time of the July submission fee savings were estimated to be in a range of £11.58m (low) to £27.68m (high). Estimated annualised fee savings based on current plans amount to between 54% (low estimate) or 22% (high estimate) of those projected in the July submission, i.e. within the range indicated at the time of submission reflecting the current AUM.
- As noted earlier in this document, LCIV business plan and MTFS sets out the plans for fund launches over the next 3 years and will continue to target fee savings as part of that plan, but as noted earlier strict comparisons become more difficult to evidence as we move away from transitioning existing mandates and procure new strategies. Further as we commented on in our July submission, we want to reinforce the message that as Funds for strategic asset allocation reasons target more complex investment structures, including infrastructure, then actual savings may not be feasible when set against the current investment strategies, although it may be possible to evidence savings versus what might have been paid by Funds without having the benefits that come from scale of assets.
- We would also like to highlight some of the risks surrounding the delivery plans for pooling, particularly given the experience to date that the CIV has had in establishing and transitioning assets:
    - Experience in transitioning common mandates – whilst on the surface Funds may appear to be investing with the same manager and mandate, below the surface the mandates can be very different and it can take considerable time and skill to reach a truly common position.
    - Local Authority Pension Investment strategies are not static and this can have an impact on implementation as Authorities adapt asset allocation for strategic reasons, this is particularly the case in pools with larger numbers of moving parts such as the LCIV.
    - Operating in a highly regulated structure with FCA, whilst adding protection for investors can also result in longer timeframes for implementation given the necessary legal and regulatory steps before funds can be launched in the new ACS structures, compared to standard Pension Fund investments or procurement exercises. The impact of MIFID II has yet to be fully understood as the details are still at consultation stage,
    - LCIV has to date been transitioning existing assets largely in-specie on a ‘lift and shift’ basis for common mandates. Increasingly as LLAs make decisions to transition from existing mandates and into completely new strategies, transition risks come into play. Whilst undoubtedly there are a range of very experienced transition managers available to call on, transitioning large quantities of assets will pose additional risks and could result in significant additional costs

if the transitions are not managed very carefully and will need to be monitored closely when undertaken.

- As a Pool already operational, LCIV is already reporting to investors providing net of fee performance data. Investors are also provided with a fee schedule on a quarterly basis with a full breakdown of all charges that are applied to the management of the assets. We have established a reporting and transparency working group to help deliver further enhancements to reporting and to ensure that Funds have access to the data that they need for reporting purposes.
- Information on all sub-funds including pricing is available to all Funds within the LCIV Pool, not just those invested in particular strategies. LCIV are currently working on a secure client portal to facilitate easier access to all LCIV information and data for shareholders and investors.

Criterion D: Infrastructure

For all pools

- Progress on infrastructure investment – please state your target allocation for infrastructure and committed funds at the pool level and/or across pools. Please also set out your plans for the platform/product/and/or external manager arrangements to achieve that target
- Timetable to achieve stated ambition.- please provide a high level project plan for the implementation of the platform/product/and/or external manager arrangements described above

LCIV Response

- We refer to our July 2016 response to Government, as noted the allocations to infrastructure across London remain relatively low at less than 1%. Where funds had indicated an interest in allocating to infrastructure then their target allocations were between 3-10%, but as government is aware this is a local asset allocation decision. As noted earlier in this response, we are working closely with our 32 London Pension Funds to better understand their future strategic asset allocation, anecdotally it would seem that a number are now including infrastructure as part of their allocation requirements going forwards, but until a full assessment of requirements has been completed, we are unable to provide further detail on target allocations going forwards. LCIV however, are very focused on looking to meet local strategic asset allocation decisions and where there is increased demand for investment opportunities in infrastructure, we will aim to provide these in a timely manner.
- LCIV continues to have discussions with a range of external infrastructure managers to ensure that essential background research has been completed and is available for investment at such time as the London Funds are ready to invest in infrastructure platforms.
- Where demand for specific asset classes is relatively low or in early stages of development on the CIV platform, LCIV will work with individual funds or small groups of funds to facilitate work and procurement exercises to look for outcomes which could be ‘CIVable’ at a future date when resources or

increased demand for specific products is identified, this is particularly the case in assets such as infrastructure and private markets.

- As part of a broader training and events schedule, LCIV are arranging an infrastructure seminar in the autumn open to Pension Committee Members and Local Authority officers. The agenda for this event is currently under consideration but will include both a training element and the opportunity to meet with a wide range of providers of infrastructure investments.
- LCIV CIO continues to be an active member of the Cross Pools Infrastructure Group and exploring opportunities for collaborative working in this area.
- The business plan agreed with the Pensions Sectoral Joint Committee and the Board of LCIV includes the opening of 2 infrastructure specific funds in the summer of 2019, (business plan and medium term financial strategy agreed February 2017: http://www.londoncouncils.gov.uk/node/31261). However it is recognised that the business plan needs to remain flexible and that investment options are subject to changes in the underlying London Local Authority investment needs to fulfil their strategic asset allocations.

Annex A

SUB-FUNDS OVERVIEW

LCIV started the financial year 2016/17 with two sub-funds opened and assets under management (AUM) of £842.6m and ended the year to 31st March 2017 with 6 sub-funds and AUM of £3,573m. The growth in AUM was attributable to a combination of sub-fund openings, market moves and subscriptions. The table below provides an overview of the sub-funds and performance over the year.

FUND (Underlying Manager)	PRICE (Pence)	FUND SIZE £M	Q1 2017	1 YEAR 01/04/16 – 31/03/17	SINCE INCEPTION	INCEPTION DATE	LONDON LOCAL AUTHORITIES INVESTED 31/03/17
LCIV Global Equity Alpha (Allianz Global Investors) ***Benchmark: MSCI World Net GBP Index***	128.7	£667	6.79% *5.12%*	30.21% *31.92%*	30.86% *34.11%*	02/12/15	3
LCIV BG Global Alpha Growth (Baillie Gifford) ***Benchmark: MSCI All Countries World Gross Index***	134.3	£1,602	7.60% *5.37%*	N/A *N/A*	35.00% *32.59%*	11/04/16	9
LCIV PY Total Return (Pyrford)	109.1	£204	1.68%	N/A	9.10%	17/06/16	3
LCIV Diversified Growth (Baillie Gifford)	114.2	£355	2.83%	10.35%	14.76%	15/02/16	6
LCIV RF Absolute Return (Ruffer)	111.2	£413	0.00%	N/A	11.50%	21/06/16	5
LCIV NW Real Return (Newton)	103.4	£332	1.97%	N/A	3.40%	16/12/16	3
Total LCIV Assets Under Management		**£3,573**					**18**

*Data Source: Bloomberg as at 31/03/17 – Net of all fees and charges with income reinvested