Public Document Pack

**Governance and Human Resources**
**Town Hall, Upper Street, London, N1 2UD**

---

## AGENDA FOR THE PENSIONS SUB COMMITTEE

---

Members of the Pensions Sub Committee are summoned to a meeting which will be held in Committee room 4, Islington Town Hall, Upper Street, London N1 2UD, on **5 March 2018 at 7.30 pm.**

**Yinka Owa**
**Director of Law and Governance**

| | | |
|---|---|---|
| Enquiries to | : | Mary Green |
| Tel | : | (0207) 527 3005 |
| E-mail | : | democracy@islington.gov.uk |
| Despatched | : | 22 February 2018 |

| Membership 2017/18 | Substitute Members |
|---|---|
| Councillor Richard Greening (Chair) | Councillor Mouna Hamitouche MBE |
| Councillor Andy Hull (Vice-Chair) | Councillor Angela Picknell |
| Councillor Michael O'Sullivan | Councillor Robert Khan |
| Councillor Paul Smith | Councillor Jenny Kay |

**Quorum is 2 members of the Sub-Committee**

## A. Formal Matters

1. Apologies for absence

2. Declaration of substitutes

3. Declaration of interests

If you have a Disclosable Pecuniary Interest* in an item of business:

- if it is not yet on the council’s register, you must declare both the existence and details of it at the start of the meeting or when it becomes apparent;
- you may choose to declare a Disclosable Pecuniary Interest that is already in the register in the interests of openness and transparency.

In both the above cases, you must leave the room without participating in discussion of the item.

If you have a personal interest in an item of business and you intend to speak or vote on the item you must declare both the existence and details of it at the start of the meeting or when it becomes apparent but you may participate in the discussion and vote on the item.

*(a) Employment, etc - Any employment, office, trade, profession or vocation carried on for profit or gain.
(b) Sponsorship - Any payment or other financial benefit in respect of your expenses in carrying out duties as a member, or of your election; including from a trade union.
(c) Contracts - Any current contract for goods, services or works, between you or your partner (or a body in which one of you has a beneficial interest) and the council.
(d) Land - Any beneficial interest in land which is within the council’s area.
(e) Licences- Any licence to occupy land in the council’s area for a month or longer.
(f) Corporate tenancies - Any tenancy between the council and a body in which you or your partner have a beneficial interest.
(g) Securities - Any beneficial interest in securities of a body which has a place of business or land in the council’s area, if the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body or of any one class of its issued share capital.

This applies to all members present at the meeting.

4. Minutes of the previous meeting 1 - 4

## B. Non-exempt items

1. Pension Fund performance 5 - 40

a. Presentation from AllenbridgeEPIC Investment Advisers on quarterly performance

2. London CIV update 41 - 46

| | | |
|---|---|---|
| 3. | Presentation from representative from London CIV | - |
| 4. | Equity protection implementation update | 47 - 50 |
| 5. | Forward Plan 2018/19 | 51 - 54 |

**C. Urgent non-exempt items**

Any non-exempt items which the Chair agrees should be considered urgently by reason of special circumstances. The reasons for urgency will be agreed by the Chair and recorded in the minutes.

**D. Exclusion of press and public**

To consider whether, in view of the nature of the remaining items on the agenda, any of them are likely to involve the disclosure of exempt or confidential information within the terms of Schedule 12A of the Local Government Act 1972 and, if so, whether to exclude the press and public during discussion thereof.

**E. Confidential/exempt items**

| | | |
|---|---|---|
| 1. | London CIV update - exempt appendix | 55 - 82 |
| 2. | Equity protection implementation update-exempt appendix | 83 - 90 |

**F. Urgent exempt items**

Any exempt items which the Chair agrees should be considered urgently by reason of special circumstances. The reasons for urgency will be agreed by the Chair and recorded in the minutes.

The next meeting of the Pensions Sub Committee is scheduled for 26 June 2018

This page is intentionally left blank

London Borough of Islington

**Pensions Sub Committee - 21 November 2017**

Non-confidential minutes of the meeting of the Pensions Sub Committee held at the Town Hall, Upper Street, N1 2UD on 21 November 2017 at 7.30 pm.

| | | |
|---|---|---|
| **Present:** | **Councillors:** | Richard Greening (Chair), Michael O'Sullivan and Paul Smith |
| **Also Present:** | | Karen Shackleton, Allenbridge<br>Norbert Fullerton, Nukeeta Kumar and Adam Lane – Mercer Limited<br>George Sharkey (member of Pension Board and observer) |

**Councillor Richard Greening in the Chair**

## 111 APOLOGIES FOR ABSENCE (Item A1)

Received from David Bennett, Thelma Harvey and David Poyser (observers from Pension Board) and Councillor Andy Hull.

## 112 DECLARATION OF SUBSTITUTES (Item A2)

None.

## 113 DECLARATION OF INTERESTS (Item A3)

None.

## 114 MINUTES OF THE PREVIOUS MEETING (Item A4)

**RESOLVED**:
That the minutes of the meeting held on 16 October 2017 be confirmed as a correct record and the Chair be authorised to sign them.

## 115 PENSION FUND PERFORMANCE - 1 JULY TO 30 SEPTEMBER 2017 (Item B1)

The Head of Pension Fund and Treasury Management pointed out that the figures in paragraph 3.3 of the report actually indicated performance with the hedge and should be amended as follows to indicate performance without the hedge:

Paragraph 3.3 – replace the figures “1.33, 1.37, 8.20% and 7.67%” with “1.34, 1.38, 8.38% and 8.8%”, respectively.

**RESOLVED**:
(a) That the performance of the Fund from 1 July to 30 September 2017, as per the BNY Mellon interactive performance report, detailed in the report of the Corporate Director of Resources, be noted.
(b) That the report by Allenbridge Investment Advisers on fund managers’ quarterly performance, detailed in Appendix 1 to the report and their presentation, including the

amendment to page 27 of the agenda by replacing the figure “8.1%” for Hearthstone’s performance over three years with “7.04%”, be noted.
(c) That, for the future, the quarterly performance figures include both the hedged and unhedged figures.
(d) That it be noted that the Head of the Pension Fund and Treasury Management would raise the matter of underperformance by London CIV – Newton at a future London CIV managers meeting and would seek a meeting with Newton.

## 117 LONDON CIV UPDATE (Item B2)

Members expressed concern that Hugh Grover, the Chief Executive, and Jill Davys, Client Relationship Director, had left London CIV and noted that their successors were from City and financial backgrounds, rather than local government. The Sub-Committee regretted the loss of local government experience in these departures.

**RESOLVED**:
(a) That the progress made at the London CIV in launching funds and running portfolios over the period from July to October 2017, as detailed in the report of the Corporate Director of Resources, be noted.
(b) That, in view of the Sub-Committee’s concern about the recent departure of the Chief Executive and the Client Relationship Director, the Chair write to the London CIV to express the Sub-Committee’s concern at the loss of local government expertise in the management team at London CIV.
(c) Noted the Sub-Committee’s interest in attending the forthcoming Infrastructure Seminar, the date for which was to be arranged.

## 118 INVESTMENT STRATEGY UPDATE - INFRASTRUCTURE (Item B3)

**RESOLVED:**
(a) That the progress made on an infrastructure procurement process, as detailed in the report of the Corporate Director of Resources, be noted.
(b) That officers collaborate with other interested local authorities in a joint tender for infrastructure.
(c) That officers continue to contribute to the London CIV infrastructure working group.

## 119 PENSIONS SUB-COMMITTEE 2017/18 - FORWARD PLAN (Item B4)

**RESOLVED:**
That the contents of Appendix A to the report of the Corporate Director of Resources, detailing proposed agenda items for future meetings, be noted.

## 120 ESG AND CLIMATE CHANGE RISK ASSESSMENT AND RATING (Item B5)

The Sub-Committee received confidential presentations from Kate Brett at Mercer on the environmental, social and governance ratings of the Fund’s existing managers and a climate risk assessment. The Sub-Committee noted that most managers had better average ESG ratings than the relevant universe.

**RESOLVED**:
(a) That the exempt presentations by Mercer on the environmental, social and governance ratings of the Fund’s existing managers and the climate change risk assessment be noted.

(b) That officers have regular follow up discussions with managers as an important element of communicating expectations on ESG and climate integration and develop investment beliefs and a strategic approach to climate risk.

## 121 EQUITY PROTECTION STRATEGY - IMPLEMENTATION (Item B6)

Norbert Fullerton and Adam Lane, from Mercer, gave a presentation on equity risk management of the Fund.

Ian Kirk, from Mercer, gave a presentation on the 2016 valuation outcomes and potential 2019 valuation outcomes. The Sub-Committee noted the deficit of £296m in the Fund as at 31 March 2016, compared to the assumed deficit of £91m by 31 March 2019, a 93% funding level. Given the very positive position, members considered that it was worth protecting the gain in the equity portfolio. It was noted that approximately one third of the Fund was held in property and corporate bonds and that, in the long term, those should deliver. There was also some demographic risk, as people were living longer, causing strain on the Fund.

Members considered options for paying for protection of the Fund ie paying a premium or not, or a combination approach of paying half the premium and giving up a percentage of gains.

**RESOLVED**:
(a) That Mercer's exempt presentation on the implementation of an equity protection strategy be noted.
(b) That the objectives for implementing an equity protection strategy be approved.
(c) That the equity protection strategy be financed by the payment of a premium, at a cost of approximately £21m, for a period up to March 2020.
(d) That the Corporate Director of Resources, in consultation with the Corporate Director of Law and Governance and the Chair of the Sub-Committee, be authorised to proceed as swiftly as possible with the procurement process and appointment of insurance provider and due diligence to procure the services of capable managers to protect the equity in the Fund.

## 122 EXCLUSION OF PRESS AND PUBLIC (Item )

**RESOLVED:**
That the press and public be excluded during consideration of the following items as the presence of members of the public and press would result in the disclosure of exempt information within the terms of Schedule 12A of the Local Government Act 1972, for the reasons indicated:

| Agenda item | Title | Reason for exemption |
|---|---|---|
| E1 | ESG and climate change risk assessment and rating – exempt appendix | Category 3 – Information relating to the financial or business affairs of any particular person (including the authority holding that information). |

| | | |
|---|---|---|
| E2 | Equity protection strategy - Implementation – exempt appendix | Category 3 – Information relating to the financial or business affairs of any particular person (including the authority holding that information). |

## 123 ESG AND CLIMATE CHANGE RISK ASSESSMENT AND RATING - EXEMPT APPENDIX (Item E1)

Noted.

## 124 EQUITY PROTECTION STRATEGY - IMPLEMENTATION - EXEMPT APPENDIX (Item E2)

Noted.

The meeting ended at 9.30 pm

**CHAIR**

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of: Corporate Director of Resources**

| **Meeting of:** | **Date** | **Agenda item** | **Ward(s)** |
|---|---|---|---|
| Pensions Sub-Committee | 5 March 2018 | | |

| | | |
|---|---|---|
| **Delete as appropriate** | ~~Exempt~~ | Non-exempt |

## Subject: PENSION FUND PERFORMANCE 1OCTOBER TO 30 DECEMBER 2017

| **1.** | **Synopsis** |
|---|---|
| 1.1 | This is a quarterly report to the Pensions Sub-Committee to allow the Council as administering authority for the Fund to review the performance of the Fund investments at regular intervals and review the investments made by Fund Managers quarterly. |
| **2.** | **Recommendations** |
| 2.1 | To note the performance of the Fund from 1 October to 30 December 2017 as per BNY Mellon interactive performance report |
| 2.2 | To receive the presentation by Allenbridge Investment Advisers, our independent investment advisers, on our fund managers' quarterly performance attached as Appendix 1. |
| 2.3 | To note the LGPS Current Issues- January 2018 |
| **3.** | **Fund Managers Performance for 1 October to December 2017** |
| 3.1 | The fund managers' latest quarter net performance figures compared to the benchmark is shown in the table below |

| Fund Managers | Asset Allocation | Mandate | Latest Quarter Performance (Oct-Dec) Gross of fees | | 12 Months to December 2017 Performance Gross of fees | |
|---|---|---|---|---|---|---|
| | | | Portfolio | Benchmark | Portfolio | Benchmark |
| LBI-In House | 14% | UK equities | 4.53% | 4.96% | 11.8% | 13.1% |
| London CIV Allianz | 8% | Global equities | 3.96% | 4.75% | 19.8% | 12.4% |
| LCIV -Newton | 15% | Global equities | 4.27% | 4.97% | 10.94% | 13.8% |
| Legal & General | 13% | Global equities | 4.68 | 4.74% | 14.81% | 16.4% |
| Standard Life | 19% | Corporate bonds | 2.11% | 1.85% | 5.03% | 4.26% |
| Aviva (1) | 5% | UK property | 1.63% | 2.58%<br>3.36% | 7.42% | 2.53%<br>11.24% |
| Columbia Threadneedle Investments (TPEN) | 6% | UK commercial property | 3.72% | 3.10% | 18.08% | 10.16% |
| Hearthstone | 2% | UK residential property | 1.38% | 3.36% | 4.18% | 11.24% |
| Schroders | 9.4% | Diversified Growth Fund | 3.31% | 2.27% | 8.72% | 9.12% |
| BMO Investments-LGM | 5.5% | Emerging/ Frontier equities | 6.18% | 6.62% | n/a | n/a |

2.58% & 2.53% = original Gilts benchmark; 3.36% and 11.24% are the IPD All property index; for information

3.2 BNY Mellon our new performance monitoring service provider now provides our quarterly interactive performance report. Performance attributions can be generated via their portal if required.

3.3 The combined fund performance and benchmark for the last quarter ending December 2017 is shown in the table below.

| | Latest Quarter Performance **Gross** of fees | | 12 Months to December 2017 Performance Gross of fees | |
|---|---|---|---|---|
| Combined Fund Performance ex-hedge | Portfolio % | Benchmark % | Portfolio % | Benchmark % |
| | 3.68 | 3.44 | 11.15% | 9.32% |

3.4 Copies of the latest quarter fund manager’s reports are available to members for information if required.

3.5 **Total Fund Position and Protection**

The Islington combined fund absolute performance with the hedge over the 1, 3 and 5 years’ period to

December 2017 is shown in the table below.

| Period | 1 year per annum | 3 years per annum | 5 years per annum |
|---|---|---|---|
| Combined LBI fund performance hedged | 11.20% | 9.03% | 9.75% |
| Customised benchmark | 9.40% | 8.60% | 9.44% |

3.6 **AllianzGI (RCM)**

3.6.1 AllianzGI (formerly known as RCM) is the fund's global equity manager and was originally appointed in December 2008. There have been amendments to the mandate, the last being a transfer to the CIV platform.

3.6.2 On 2 December, the portfolio was transferred to the London CIV platform to Allianz sub fund as agreed by Members at the November 2015 meeting. The new benchmark is to outperform the MSCI World Index. The outperformance target is MSCI World +2% per annum over 2 years net of fees.

3.6.3 This quarter the fund returned 3.9% against a benchmark of 4.7%. Since inception with the London CIV in December 2015, there is a relative over performance of 13.6% whiles since January 2009 the relative outperformance is 0.08%. The main drivers were stock selection and country allocation in Information Technology, and Healthcare. The portfolio holds 47 stocks.

3.7 **Newton Investment Management**

3.7.1 Newton is the Fund's other global equity manager with an inception date of 1 December 2008. There has been amendments to the mandate the latest being a transfer to the London CIV platform.

3.7.2 The inception date for the LCIV NW Global Equity Fund was 22 May 2017. The new benchmark is the MSCI All Country World Index Total return. The outperformance target is MSCI All Country Index +1.5% per annum net of fees over rolling three- year periods.

3.7.3 The fund underperformed by returning 4.27% gross of fees against a benchmark of 4.97% for the December quarter. Since inception the fund has delivered an absolute return of 12.63% but relative under performance of -0.5% gross of fees per annum

3.7.4 The under performance this quarter was driven mainly by stock selection in health care and information technology sectors. The LCIV has now put Newton on their watch list.

3.8 **In House Tracker**

3.8.1 Since 1992, the UK equities portfolio of the fund has been managed in-house by officers in the Loans and Investment section by passive tracking of the FTSE 350 Index. The mandate was amended as part of the investment strategy review to now track the FTSE All Share Index within a +/- 0.5% range per annum effective from December 2008. After a review of the fund's equities, carbon footprint Members agreed to now track the FTSE UK All Share Carbon Optimised Index and this became effective in September 2017.

3.8.2 The fund returned 4.53% against FTSE All Share Index benchmark of 4.96 % for the December quarter and a relative over performance of 0.18% over the five- year period. The portfolio is now mirroring the low carbon index .

3.9 **Standard Life**

3.9.1 Standard Life has been the fund’s corporate bond manager since November 2009. Their objective is to outperform the Merrill Lynch UK Non Gilt All Stock Index by 0.8% per annum over a 3 year rolling period. During the December quarter, the fund returned 2.1% against a benchmark of 1.85% and an absolute return of 7.6% per annum since inception.

3.9.2 The main driver behind the performance in this quarter was positive asset allocation with overweight positions in subordinated financial bond and secured debt and underweight exposure to supranationals

3.9.3 The forward strategy is to remain overweight credit risk but use opportunities to take profits and gradually de-risk portfolios

3.10 **Aviva**

3.10.1 Aviva manages the fund’s UK High Lease to Value property portfolio. They were appointed in 2004 and the target of the mandate is to outperform their customised gilts benchmark by 1.5% (net of fees) over the long term. The portfolio is High Lease to Value Property managed under the Lime Property Unit Trust Fund.

3.10.2 The fund for this quarter delivered a return of 1.6% against a gilt benchmark of 2.58%. The All Property IPD benchmark returned 3.36% for this quarter. Since inception, the fund has delivered an absolute return of 6.12% net of fees.

3.10.3 This December quarter the fund’s unexpired average lease term is now 19.7years. During the quarter 5 new investments were acquired. Lime fund is well positioned to deliver attractive returns over the medium term.

3.10.4 The fund also has £371m of investor cash (£30m newly signed subscriptions in the December quarter.) The current queue period to invest is around 12-18months. As agreed, our fund has now committed £50m to the Lime Fund.

3.11 **Columbia Threadneedle Property Pension Limited (TPEN)**

3.11.1 This is the fund’s UK commercial pooled property portfolio that was fully funded on 14 October 2010 with an initial investment of £45 million. The net asset value at the end of December was £78.3million.

3.11.2 The agreed mandate guidelines are as listed below:

- Benchmark: AREF/IPD All Balanced Property Fund Index (Weighted Average) since I January 2014.
- Target Performance: 1.0% p.a. above the benchmark (net of fees) over three year rolling periods.
- Portfolio focus is on income generation with c. 75% of portfolio returns expected to come from income over the long term.
- Income yield on the portfolio at investment of c.8.5% p.a.
- Focus of portfolio is biased towards secondary property markets with high footfall rather than on prime markets such as Central London. The portfolio may therefore lag in speculative/bubble markets or when the property market is driven by capital growth in prime markets.

3.11.3 The fund returned a relative outperformance return against its benchmark 0.6% for the December quarter and a nil three - year relative return. The cash balance now stands at 5.4% compared to 8.9% last quarter and with post Brexit uncertainties, will continue to adopt a conservative cash management strategy. During the quarter there was one acquisition totalling £43.5m. There is a strong asset diversification at portfolio level with a total of 278 properties.

3.11.4 The medium to long term prospects of commercial property post referendum are likely to be a catalyst for moderate capital value declines but the fund is cushioned by its high relative income return and maximum diversification at both portfolio and client level.

3.12 **Passive Hedge**

3.12.1 The fund currently targets to hedge 50% of its overseas equities to the major currencies dollar, euro and yen. The passive hedge is run by BNY Mellon our custodian. At the end of the December quarter, the hedged overseas equities were valued at £6.8m.

3.13 **Franklin Templeton**

3.13.1 This is the fund's global property manager appointed in 2010 with an initial investment commitment of £25million. Members agreed in September 2014 to re-commit another $40million to Fund II to keep our investments at the same level following return of capital through distributions from Fund I. The agreed mandate guidelines are listed below:

- Benchmark: Absolute return
- Target Performance: Net of fees internal rate of return of 15%. Preferred rate of return of 10% p.a. with performance fee only applicable to returns above this point.
- Bulk of capital expected to be invested between 2 – 4 years following fund close.

- Distributions expected from years 6 – 8, with 100% of capital expected to be returned approximately by year 7.

3.13.2 Fund I is now fully committed and drawndown, though $7.1m can be recalled in the future as per business plans. The final portfolio is comprised of nine funds and five co-investments. The funds is well diversified as shown in table below:

| Commitments | Region | % of Total Fund |
|---|---|---|
| 5 | Americas | 36 |
| 4 | Europe | 26 |
| 5 | Asia | 38 |

During the quarter there was a net distribution of $2.0m to bring the total distribution received to $48m

3.13.3 Fund II has made 5 investments to date in Europe, USA and Asia, in the retail and office sector and the projected geographic exposure is 42% Asia, US 26% and 32% Europe. The Admission period to accept new commitments from investors has been extended with our consent through to March 2017. The total capital call to the quarter end was $17.4.m and a distribution of $2.5m.

3.14. **Legal and General**

3.14.1 This is the fund's passive overseas equity index manager. The fund inception date was 8 June 2011 with an initial investment of £67million funded from transfer of assets from AllianzGI (RCM). The funds were managed passively against regional indices to formulate a total FTSE All World Index series. Member agreed restructuring in 2016 in now complete and the funding of BMO (our emerging market manager and restructuring of the fund to the MSCI World Low Carbon was completed on 3rd July over 7 weeks at a cost of £232k.

3.14.2 The components of the new mandate as at the end of June inception was £138m benchmarked against MSCI World Low Carbon Index and £28m benchmarked against RAFI emerging markets.
For the December quarter, the fund totalled £177m with a performance of 4.7% and relative return of -0.06 %.

3.15 **Hearthstone**

3.15.1 This is the fund’s residential UK property manager. The fund inception date was 23 January 2013, with an initial investment of £20million funded by withdrawals from our equities portfolios. The agreed mandate guidelines are as follows:

- Target performance: UK HPI + 3.75% net income.
- Target modern housing with low maintenance characteristics, less than 10 years old.
- Assets subject to development risk less than 5% of portfolio.
- Regional allocation seeks to replicate distribution of UK housing stock based on data from Academics. Approximately 45% London and South East.
- 5-6 locations per region are targeted based on qualitative and quantitative assessments and data from Touchstone and Connells.
- Preference is for stock which can be let on Assured Shorthold Tenancies (ASTs) or to companies.
- Total returns expected to be between 6.75% and 8.75% p.a., with returns split equally between income and capital growth. Net yields after fund costs of 3.75% p.a.
- The fund benchmark is the LSL Academetrics House Price Index

3.15.2 For the December, quarter the value of the fund investment was £27.1m and total funds under management is £56million. Performance net of fees was 1.38% compared to the LSL benchmark of -0.25%.

The income yield after cost was 3.4%. The portfolio has 186 properties and 1set of parking spaces (17 have been sold from the 203), 6 are let on licence and leaseback agreement to house builders and 165 properties let on assured short term agreements.

3.15.3 There are 15 vacant properties, 2 of which are being sold, 13 being marketed for rent all of which are re-lets. Rental income lost due to vacant properties was 6.22%.

3.16 **Schroders-**

3.16.1 This is the Fund’s diversified growth fund manager. The fund inception date was 1 July 2015, with an initial investment of £100million funded by withdrawals from our equities portfolios**.** The agreed mandate guidelines are as follows:

- Target performance: UK RPI+ 5.0% p.a.,
- Target volatility: two thirds of the volatility of global equities, over a full market cycle (typically 5 years).
- Aims to invest in a broad range of assets and varies the asset allocation over a market cycle.
- The portfolio holds internally managed funds, a selection of externally managed products and some derivatives.
- **Permissible asset class ranges (%):**
  - 25-75: Equity
  - 0- 30: Absolute Return
  - 0- 25: Sovereign Fixed Income, Corporate Bonds, Emerging Market Debt, High Yield Debt, Index-Linked Government Bonds, Cash
  - 0-20: Commodities, Convertible Bonds
  - 0- 10: Property, Infrastructure
  - 0-5: Insurance-Linked Securities, Leveraged Loans, Private Equity.

3.16.2 This is the tenth quarter since funding and the value of the portfolio is now £129m including an additional cash injection of £15m**.** The aim is to participate in equity market rallies, while outperforming in falling equity markets. The December quarter performance before fees was 3.3% against the benchmark of 2.3% (inflation+5%). The one -year performance is 8.7% against benchmark of 9.1% before fees.

Global value equities and regional allocations US and Europe and Emerging markets made strong contributions to returns, however currency translation detracted from returns.

3.16.3 Mercer have downgraded Schroders and will be on hand to give some of the reasoning behind it.

3.17 **BMO Global Assets Mgt**

This is the new emerging and frontier equity manager seeded in July 2017 with a total £74.4m withdrawn from LGIM. The mandate details as follows:

- A blended portfolio with 85% invested in emerging market and 15% in frontier markets
- Target performance MSCI Emerging Markets Index +3.0% (for the global emerging markets strategy)
- Expected target tracking error 4-8% p.a
- The strategy is likely to have a persistent bias towards profitability, and invests in high quality companies that pay dividend

3.17.1 The December quarter saw a combined performance of 6.18% against a benchmark of 6.6% before fees. The detraction is mainly due underweight position in Argentinean market and stock selection

The strategy remains to continue to research new companies that we suspect might be worthy of your hard earned capital and continue to have a close communication with our existing investments to push them to higher business and governance standards which we believe will ultimately enhance your long term return.

## 4. Implications

4.1 **Financial implications:**

The fund actuary takes investment performance into account when assessing the employer contributions payable, at the triennial valuation.

Fund management and administration fees and related cost are charged to the pension fund.

4.2 **Legal Implications:**

As the administering authority for the Fund, the Council must review the performance of the Fund investments at regular intervals and review the investments made by Fund Managers quarterly.

4.3 **Resident Impact Assessment:**

The Council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The Council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The Council must have due regard to the need to tackle prejudice and promote understanding".

An equalities impact assessment has not been conducted because this report is an update on performance of existing fund managers and there are no equalities issues arising**.**

4.4 **Environmental Implications**

None applicable to this report.

## 5. Conclusion and reasons for recommendations

5.1 Members are asked to note the performance of the fund for the quarter ending December 2017as part of the regular monitoring of fund performance.

**Background papers:**

1. Quarterly management reports from the Fund Managers to the Pension Fund.
2. Quarterly performance monitoring statistics for the Pension Fund – BNY Mellon

Final report clearance:

**Signed by:**

| | | |
|---|---|---|
| | Corporate Director of Resources | Date |
| **Received by:** | | |
| | Head of Democratic Services | Date |

| | |
|---|---|
| Report Author: | Joana Marfoh |
| Tel: | 0207-527-2382 |
| Fax: | 0207-527 -2056 |
| Email: | joana.marfoh@islington.gov.uk |

This page is intentionally left blank

REPORT PREPARED FOR

# London Borough of Islington Pension Fund

February 2018

**Karen Shackleton**
**Allenbridge**

karen.shackleton@allenbridge.com
www.allenbridge.com
www.mjhudson.com

This document is directed only at the person(s) identified above on the basis that they are a professional investor or professional customer. It is issued by Allenbridge. Allenbridge is a trading name of AllenbridgeEpic Investment Advisers Limited and Allenbridge Limited which are all appointed representative of MJ Hudson Advisers Limited which is Authorised and Regulated by the Financial Conduct Authority (FCA).

We understand that your preference is for your advisers to issue investment advice in the first person. We recognise that this preference is a matter of style only and is not intended to alter the fact that investment advice will be given by AllenbridgeEpic Investment Advisers Limited, an exempt person under FSMA as required by the Pensions Act.

AllenbridgeEpic Investment Advisers Limited is a subsidiary of MJH Group Holdings Ltd.

## 1. Fund Manager Overview

Table 1 provides an overview of the external managers, in accordance with the Committee's terms of reference for monitoring managers.

**Table 1**

| Manager | Leavers, joiners and departure of key individuals | Performance | Assets under management | Change in strategy/risk | Manager specific concerns |
|---|---|---|---|---|---|
| **London CIV - Allianz** | Monitored by London CIV – no changes reported. | Underperformed in the quarter to December 2017, by -0.79%. Outperforming by +1.4% p.a. over 3 years to end December 2017 but behind the target of +2.0% p.a. | London CIV sub fund had £742 million of assets under management as at end September 2017, an increase of £27 million since end September. | | |
| **London CIV – Newton** | Monitored by London CIV – no changes reported. | Underperformed the Index by -0.69% in the quarter and behind the benchmark over three years by -1.58% per annum. | London CIV sub fund had £641 million of assets under management as at end September 2017, £20 million less than at end September. | | London CIV has put this sub-fund "on watch" following concerns over key personnel changes on the real return fund and FCA investigations. |
| **BMO/LGM** | No leavers in Q4. BMO allocated a dedicated ESG analyst to LGM in the quarter. | Underperformed the benchmark by -0.44% in the second quarter of this new mandate. | | | |

| **Manager** | **Leavers, joiners and departure of key individuals** | **Performance** | **Assets under management** | **Change in strategy/risk** | **Manager specific concerns** |
|---|---|---|---|---|---|
| **Standard Life** | 4 joiners and 9 leavers in the quarter. | Outperformed the Index by +0.29% in Q4 2017. Over three years the Fund is +0.58% p.a. ahead of the benchmark return but behind the performance target of +0.8% p.a. | Fund value fell slightly to £3,461 million in Q4 2017. Islington's holding stood at 7.3% of the Fund's value. | | The merger of Aberdeen Standard Investments is continuing and should be closely monitored. |
| **Aviva** | 9 joiners and 6 leavers in the real estate team, including one joiner in the Lime Fund team and one internal transfer to the team. | Underperformed the gilt benchmark by -0.95% for the quarter to December 2017 but ahead of the gilt benchmark by +2.03% p.a. over three years, net of fees. | Fund was valued at £2.04 billion as at end Q4 2017. London Borough of Islington owns 3.1% of the Fund. | | Aviva have extended their expectation of when the additional allocation will be invested from Q4 2018 to Q2 2019. |
| **Columbia Thread-needle** | There were no leavers from the property team in Q4. Ben Kelly joined the investment team as a Responsible Investment Analyst. | Outperformed the benchmark return by +0.61% in Q4 and ahead of the benchmark by +0.35% per annum over three years. Trailing the performance target of 1% p.a. outperformance. | Pooled fund has assets of £1.91 billion. London Borough of Islington owns 4.4% of the fund. | | |
| **Legal and General** | None reported | Funds are tracking as expected. | LGPS assets under management of £52 billion at end June 2017. | | |

| Manager | Leavers, joiners and departure of key individuals | Performance | Assets under management | Change in strategy/risk | Manager specific concerns |
|---|---|---|---|---|---|
| **Franklin Templeton** | No leavers in Q4. John Levy has joined as Director of Impact in the real estate team. | Portfolio return over three years was +20.01% p.a., well ahead of the target of 10% p.a. | | | |
| **Hearth-stone** | Peter Beaumont, Executive Director, and Mark Drysdale, Joint Fund Manager, left the firm in Q4. | Underperformed the IPD UK All Property Index by -1.9% in Q4 but outperforming by +0.75% p.a. over three years to end December 2017. | Fund was valued at £56.5 million at end Q4 2017. London Borough of Islington owns 49% of the fund. | | Hearthstone have had a first close on a new fund directed towards institutional investors. |
| **Schroders** | 50 joiners and 29 leavers in the UK business. Lyndon Bolton, the client relationship manager has announced his retirement at the end of February. | Fund returned +3.31% during the quarter and +8.72% over 12 months, -0.40% behind the target return. | Total assets under management of £419.6 billion as at end September 2017. | | |

**Key to shading in Table 1:**

░ Minor concern

▒ Monitoring required

## 2. Individual Manager Reviews

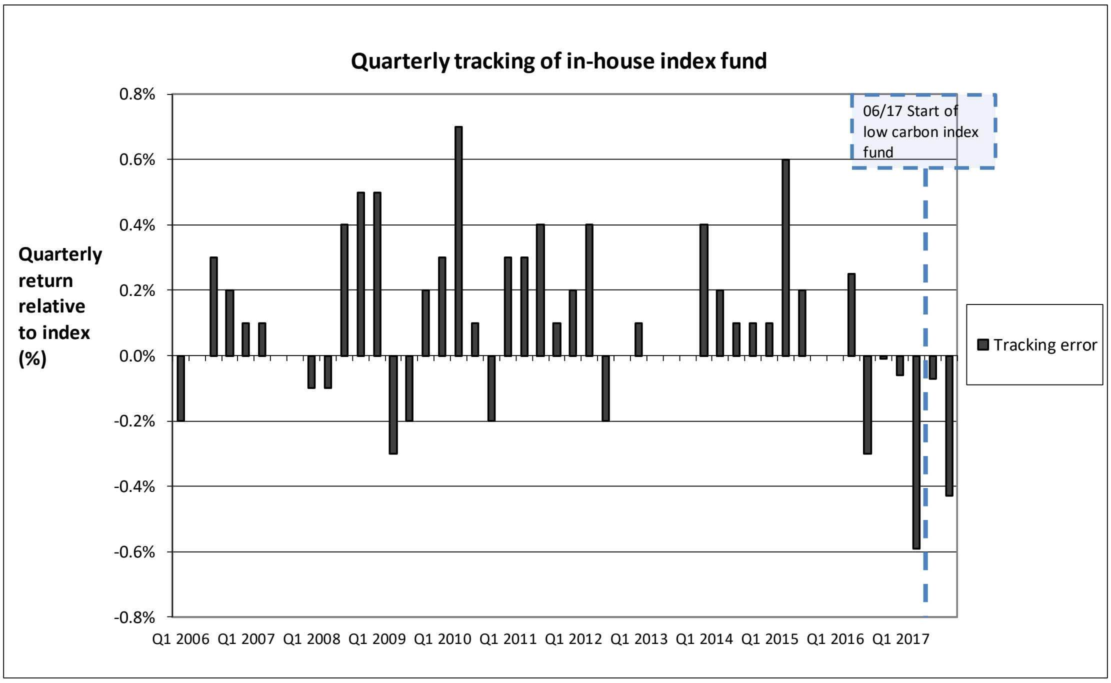
### 2.1. In-house – Passive UK Equities – FTSE All Share Index Fund

***Headline comments***: The portfolio continues to meet its objectives. The fund delivered a quarterly return of +4.53%, which was -0.4% behind the index benchmark return of +4.96%. Over three years the fund is very slightly behind the index by -0.01% p.a. but delivered a strong return of +10.06% per annum.

***Mandate summary***: A UK equity index fund which, since June 2017, is designed to match the total return on the FTSE UK All Share Carbon Optimised Index. The in-house manager uses Barra software to create a sampled portfolio whose risk/return characteristics match those of the low carbon index. The FTSE UK All Share Carbon Optimised Index itself is expected to perform in a similar way to the FTSE All Share Index.

***Performance attribution:*** Chart 1 shows the tracking error of the in-house index fund against the FTSE All Share Index from Q1 2006. **There are no performance issues.** Over three years, the portfolio has very slightly underperformed its three-year benchmark by -0.01% per annum.

**Chart 1**



Source: Allenbridge based on BNY Mellon performance calculations

***Portfolio risk:*** The index fund's transition into a low carbon passive portfolio was completed in September 2017. As at quarter end, the portfolio had a tracking error of 0.24% against the FTSE UK All Share Carbon Optimised Index with 297 stocks. The most underweight sector was Consumer Staples where the portfolio held a 13.63% allocation compared with the Index weighting of 14.40%. The most overweight sector was Industrials: the portfolio allocation was 9.10% compared with the Index weighting of 8.71%.

## 2.2. London CIV – Global Equity Alpha Fund – Allianz

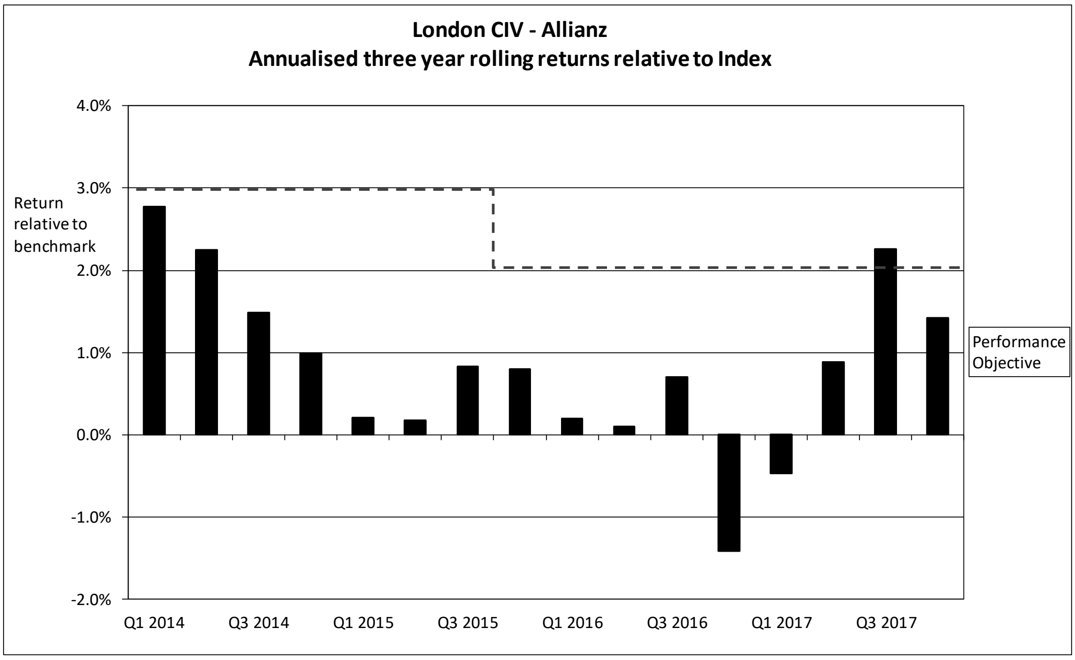
***Headline comments:*** After three quarters of outperformance, the London CIV – Allianz sub fund was unable to maintain its track record and underperformed the index by -0.79% in Q4 2017. The fund delivered a return of +3.96% against the benchmark return of +4.75% in Q4. Over three years, however, the fund outperformed by +1.42% per annum, beating the new performance target (+2% per annum over benchmark since transitioning to the London CIV).

***Mandate summary:*** An active global equity portfolio, with a bottom-up global stock selection approach. A team of research analysts identifies undervalued stocks in each geographical region (Europe, US, Asia Pacific). A global portfolio team is responsible for constructing the final portfolio. The objective of the fund (since Q4 2015) is to outperform the MSCI World Index by 2.0% per annum over rolling 3-year periods net of fees.

***Performance attribution:*** For the three years to December 2017, the AllianzGI portfolio is ahead of its benchmark by +1.42% per annum but trailing the performance target of 2% outperformance per annum, shown by the dotted line in Chart 2. Note that the dotted line drops in Q4 2015 when the mandate transferred to the London CIV sub fund, which has a lower performance objective than when Allianz ran a bespoke mandate for London Borough of Islington.

The portfolio's underperformance in Q4 was attributed by the London CIV to poor stock selection in Consumer Discretionary and Materials sectors. These sectors experienced a rally, but the fund held underweight positions, particularly in Materials. The underperformance was somewhat offset by positive contributions from holdings in Financials and Energy stocks.

**Chart 2**



Source: Allenbridge based on BNY Mellon performance data

***Portfolio Risk:*** The active share in the portfolio stood at 90.1% as at end December 2017. The active share is a measure of the percentage of stock holdings in a manager's portfolio that differ from the benchmark index.

***Portfolio Characteristics:*** as at end Q4 2017, the portfolio held 47 stocks (2 fewer stocks than at the end of the previous quarter) and had annual turnover of 15.7%.

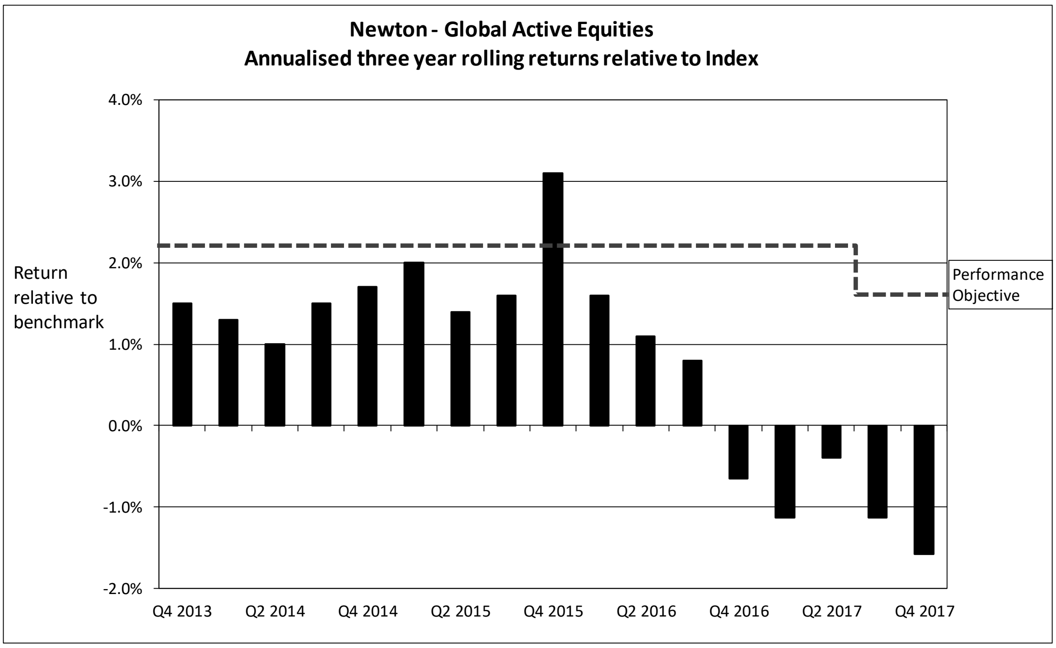
### 2.3. London CIV - Newton – Global Active Equities

***Headline comments:*** Newton underperformed their benchmark by -0.69% during Q4 2017. They have now delivered underperformance in seven out of the past eight quarters. Over three years the portfolio has underperformed the benchmark by -1.58% per annum, well behind the target of +2% p.a. This mandate is now part of the pension fund's pooled assets on the London CIV.

***Mandate summary:*** An active global equity portfolio. Newton operates a thematic approach based on 12 key themes that impact the economy and industry. Some are broad themes that apply over the longer term; others are cyclical. Stock selection is based on the industry analysts' thematic recommendations. The objective of the fund since 22nd May 2017 is to outperform the FTSE All World Index by +1.5% per annum over rolling 3-year periods, net of fees.

***Performance attribution:*** Chart 3 shows the three year rolling returns of the portfolio relative to the Index (the black bars) and compares this with the performance target, shown by the dotted line. Note that the dotted line drops after Q2 2017 when the mandate transferred to the London CIV sub fund, which has a lower performance objective than when Newton ran a bespoke mandate for London Borough of Islington.

**Chart 3**



Source: Allenbridge based on BNY Mellon performance numbers

For the three-year period to the end of Q4 2017, the fund (shown by the right hand black bar) has trailed the benchmark by -1.58% per annum. This also means it is trailing the performance objective. Much of the three-year track record has been impacted by very poor performance over the past 12-18 months. The portfolio has underperformed the benchmark in seven out of eight quarters to end December 2017.

The London CIV attributed the underperformance to a zero holding in the Materials sector which rallied during the quarter. This was somewhat offset by an overweight allocation to Information Technology and strong performance in the Industrials holdings.

***Portfolio Risk:*** The largest regional allocation was in North American equities (49.01%), followed by Western Europe (20.54%), Japan (9.16%), Asia Pacific (2.49%), and Other (4.70%). The London CIV did not provide sector or regional weightings relative to the Index.

***Portfolio characteristics:*** At the end of Q4 2017, assets under management in the London CIV – Newton sub fund stood at £641 million, £20 million lower than as at end September. London Borough of Islington’s holding represents 31.3% of the Fund.

***Staff turnover:*** There were no staff changes reported on the global equity team, although the Chief Executive, Hanneke Smits, announced some managerial changes in the real return team and multi asset team.

***London CIV rating***: during the quarter, the London CIV notified investors that they had placed Newton on a “watch” rating. This occurred because of two key concerns: first, concerns over the staff changes in the real return fund, and second, the FCA investigation into a regulatory breach which occurred in 2015. Having written to Newton, the London CIV remained unsatisfied with the response they received, and have indicated that, if concerns cannot be addressed, they will seek to terminate their relationship with the manager.

### 2.4. BMO/LGM – Emerging market equities

***Headline comments:*** The total portfolio delivered a return of +6.18% in Q4 2017, compared with the benchmark return of +6.62%. The emerging market component of this portfolio returned +7.00% compared with the index return of +7.44%. The frontier markets portfolio was also behind the index, delivering a return of +7.40% against the index return of +7.56%.

***Mandate summary:*** the manager invests in a selection of emerging market and frontier market equities, with a quality and value, absolute return approach. The aim is to outperform a combined benchmark of 85% MSCI Emerging Markets Index and 15% MSCI Frontier Markets Index by at least 3% per annum over a 3-5 year cycle.

***Performance attribution:*** during the quarter, positive contributors to performance for the emerging markets portfolio came from Mr Price (+1.9%), Vietnam Dairy Products (+1.2%) and Bank Madiri Persero (+0.9%). Companies which detracted from performance included Magnit (-0.6%) and Grupo Financiero Banorte (-0.6%).

In the frontier market portfolio, positive contributors included Eastern Tobacco (+3.2%), Vietnam Dairy (+2.8%) and BBVA Banco Frances (+1.2%). Companies which detracted from performance included Ledo (-0.4%) and Aramex (-0.4%).

***Portfolio risk:*** Note that both portfolios held Vietnam Dairy Products as at the end of December. This company performed strongly in December and had increased by 38% in

US dollar terms since the end of October 2017, following news that Jardine Group had started to acquire a 10% position.

The largest overweight country allocation in the emerging markets portfolio was India (+10.6% overweight). The most underweight country allocation was South Korea (-15.4%). For the frontier markets portfolio, the most overweight country allocation was Egypt (+12.4%) and the most underweight was Argentina (-21.6%).

***Portfolio characteristics:*** as at end December 2017, the emerging markets portfolio held 37 stocks (compared with the benchmark which had 846). The frontier markets portfolio also held 37 stocks (compared with the benchmark which had 111).

***Organisation:*** There was one new joiner to the LGM team in Q4 2017: Juan Salazar became a dedicated LGM ESG Analyst.

## 2.5. Standard Life – Fixed Income

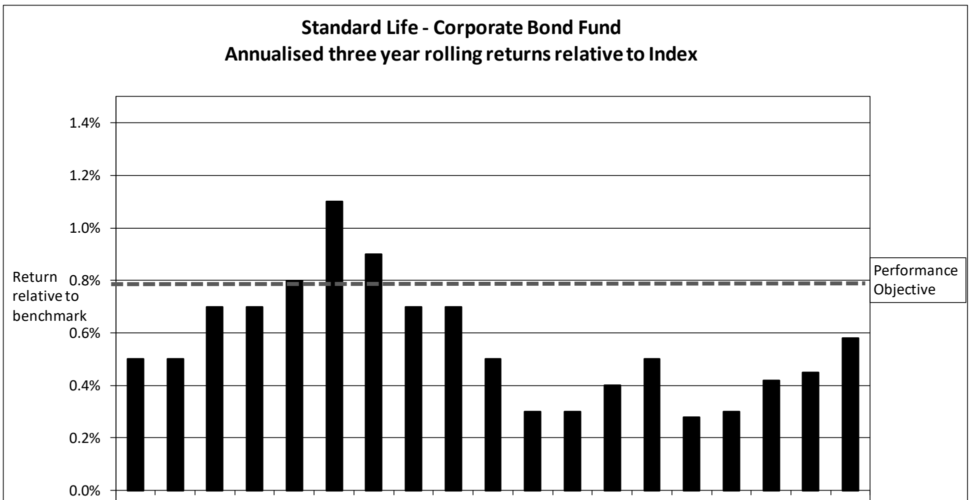
***Headline comments:*** The portfolio was ahead of the benchmark by +0.26% during the quarter, delivering a return of +2.92%. Over three years, Standard Life's return, net of fees, was +0.58% p.a. ahead of the benchmark return of +5.13% p.a., but slightly behind the performance target of +0.8% per annum.

***Mandate summary:*** An actively managed bond portfolio, invested in Standard Life's Corporate Bond Fund. The objective of the fund is to outperform the iBoxx Sterling Non-Gilt Index by 0.8% per annum over rolling 3-year periods.

***Performance attribution:***

Chart 4 shows the three-year performance of the Corporate Bond Fund compared to the Index, over the past three years. This shows the fund ahead of the benchmark over three years (right hand bar), but trailing the performance objective (shown by the dotted line in Chart 4).

**Chart 4**



Source: Allenbridge based on BNY Mellon performance data

Over three years, the portfolio has returned +5.70% p.a. compared to the benchmark return of +5.13% p.a. Over the past three years, stock selection has added 0.41% value, followed by asset allocation (+0.17%). This has been offset slightly by a negative contribution to performance from curve plays.

***Portfolio Risk:*** The largest holding in the portfolio at quarter end was EIB 5.625% 2032, at 1.4% of the portfolio.

The largest overweight sector position remained Financials (+7.7%) and the largest underweight position remained sovereigns and sub-sovereigns (-15.0%).

The fund holds 4.2% of the portfolio in non-investment grade bonds.

***Portfolio characteristics:*** The value of Standard Life's total pooled fund at end December 2017 fell in value to £3,461 million, roughly the same level as at the end of Q3 2017. London Borough of Islington's holding of £251.7 million stood at 7.3% of the total fund value (compared to 7.1% last quarter). It is worth noting that this is at its highest level since inception.

***Staff turnover:*** there were four joiners during the quarter (none in fixed income) and nine leavers.

***Organisation***: the merger of Aberdeen Standard Investments is continuing and should be closely monitored. There are likely to be further announcements regarding specific teams in the coming months.

### 2.6. Aviva Investors – Property – Lime Property Fund

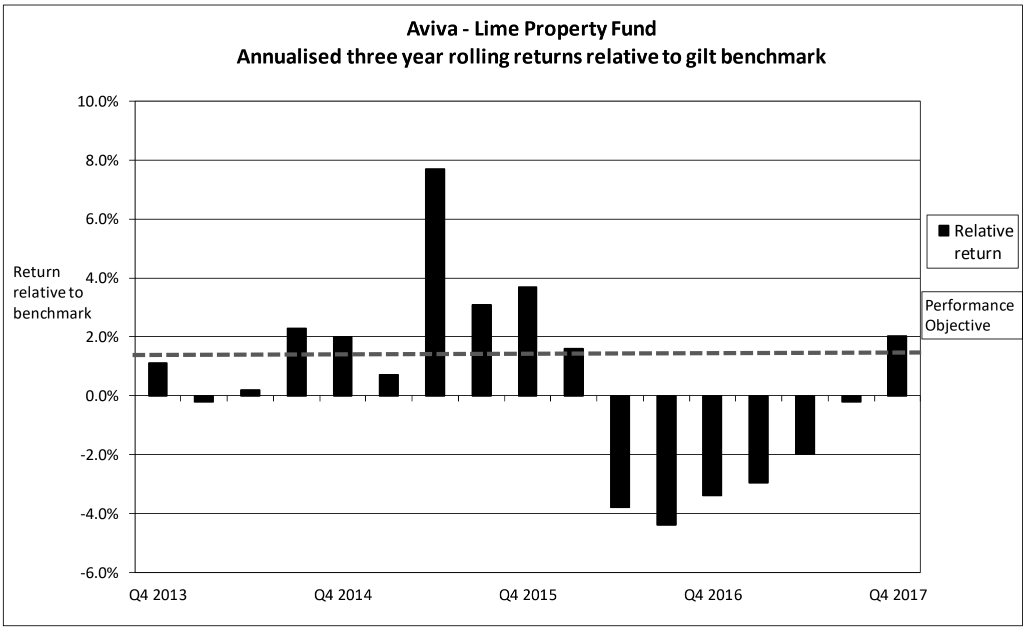
***Headline comments:*** The Lime Fund delivered return of +1.63% in Q4, compared with the benchmark which returned +2.58%, an underperformance of -0.95%. Over three years, however, the fund is ahead of the gilt benchmark, net of fees, by +2.03% p.a., ahead of the target of +1.5% p.a. The new allocation to the Lime Fund is in a queue and Aviva now expect this to be drawn down in Q2 2019 (compared with the previous expectation of end 2018).

***Mandate summary:*** An actively managed UK pooled property portfolio, the Lime Fund invests in a range of property assets including healthcare, education, libraries, offices and retail. The objective of the fund is to outperform a UK gilt benchmark, constructed of an equally weighted combination of the FTSE 5-15 Years Gilt Index and the FTSE 15 Years+ Gilt Index, by +1.5% per annum, over three year rolling periods.

***Performance attribution:*** The Fund's Q4 2017 return of +1.68% was attributed by Aviva to +1.1% from income, with the balance from capital gains.

Over three years, the fund has returned +7.28% p.a. net of fees, compared to the gilt benchmark of +5.25% p.a., an outperformance of +2.03% per annum. The **portfolio is ahead of its performance objective of +1.5% per annum outperformance over three years**, as can be seen in Chart 5.

**Chart 5**



Source: Allenbridge based on WM and BNY Mellon performance data

Of the +7.28% p.a. fund return over three years, 4.51% p.a. came from income, with the balance from capital gain.

***Portfolio risk:*** The fund acquired five new assets in Q4 2017 totalling £270 million. These included an office in Bristol, a mixed-use asset in Plymouth, a university building in Hamilton, a hotel in Cardiff, and an office building in Salford. The fund sold one asset: the HSBC building in Cardiff, form £8.9 million.

The average unexpired lease term was 19.7 years as at end December (compared with 19.3 years at end September). 11.7% of the portfolio's lease exposure in properties is in 30-35 year leases, the largest sector exposure remains offices at 29.1%, and the number of assets in the portfolio rose to 79 (74 as at end September). The weighted average unsecured credit rating of the Lime Fund remained A- as at end December 2017.

The fund received an additional £37 million during the quarter from new and additional investors. The length and size of the queue for investment is a minor concern, because London Borough of Islington is one of the parties waiting for monies to be drawn down. Aviva recently announced that they expect to begin the draw down process, for London Borough of Islington, in Q2 2019, compared with Q4 2018 as previously notified. Aviva have attributed the reason for extending the drawdown period to improved forecasting. They are now preparing more detailed reports on the completed and pipeline deals, what stage they are, what type of deal they are and when funding is required. This has enabled them to produce a more realistic timeframe for future drawdowns.

***Portfolio characteristics:*** As at end December 2017, the Lime Fund had climbed above the £2 billion mark, being valued at £2.037 billion. London Borough of Islington's investment represents 3.1% of the total fund.

The Fund had 64.3% allocated to inflation-linked rental uplifts as at end December 2017.

***Staff turnover/organisation:*** There wer nine new joiners and six leavers from the real estate team during Q4. Isabel Gossling joined the Lime Fund team as an Origination Manager. She will assist in exploring new opportunities for the Fund to invest in, with a focus on origination in the corporate sector which will complement the existing team's origination capabilities with the public sector.

In addition, Aviva announced the appointment of Tom Witherall as Assistant Fund Manager on the Lime Fund. He has spent the last three years as an Assistant Fund Manager on Aviva's REaLM Commercial Assets fund and will continue to combine both roles.

## 2.7. Columbia Threadneedle - Pooled Property Fund

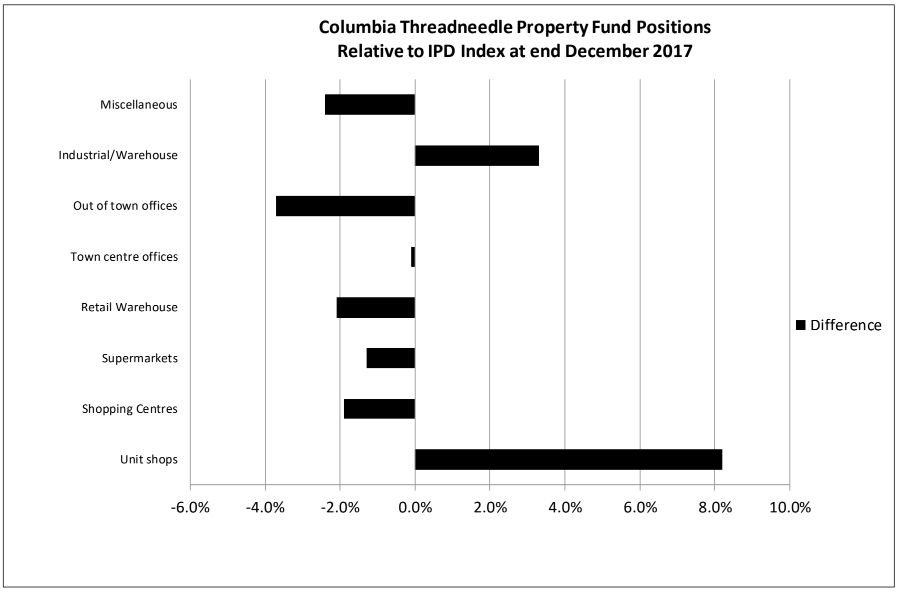
***Headline comments:*** The Fund delivered a return of +3.72% in Q4 2017, ahead of the benchmark return of +3.10%. Over three years, the Fund has outperformed the benchmark by +0.35% per annum, although this is behind the performance target of 1% p.a. above benchmark. Over five years the performance target has very nearly been met (+0.94% per annum).

***Mandate summary:*** An actively managed UK commercial property portfolio, the Columbia Threadneedle Pooled Property Fund invests in a diversified, multi-sector portfolio of UK property assets. Its performance objective is to outperform the AREF/IPD All Balanced – Weighted Average (PPFI) Index by at least 1% p.a., net of fees, on a rolling three-year basis.

***Performance attribution:*** The portfolio outperformed the benchmark by +0.61% in Q4 2017, delivering a return of +3.72%. Over three years, the Fund is ahead of its benchmark by +0.35% per annum but is trailing the performance target of +1% per annum. The absolute return over three years continues to decline: two years ago, the three-year return was as high as 13.4% per annum.

***Portfolio Risk:*** Chart 6 shows the relative positioning of the Fund compared with the benchmark.

**Chart 6**



Source: Allenbridge based on Columbia Threadneedle data.

As previously mentioned, the overweight allocation to unit shops is skewed because IPD (against which the portfolio is measured) classifies two of the largest properties in Threadneedle's portfolio as retail. These are the Heals building and the South Molton Street property. In fact, based on square footage, these assets are significantly more office than retail.

During the quarter, the Fund invested in the Network North portfolio totalling £43.25 million. This consists of 18 stand-alone and multi-let industrial distribution assets located in the North West and North East.

***Portfolio characteristics:*** As at end December 2017, the Threadneedle Property Fund was valued at £1.91 billion, an increase of £49.3 million compared with September 2017. London Borough of Islington's investment represented 4.4% of the Fund as at end December 2017.

***Staff turnover:*** There were no leavers from the property team in Q4. Ben Kelly joined the real estate investment team as a Responsible Investment Analyst.

## 2.8. Legal and General Investment Management (LGIM) – Overseas Equity Index Funds

***Headline comments:*** The index funds were within the expected tracking range when compared with their respective benchmarks.

***Mandate summary:*** Following a change in mandate in June 2017, the Fund invests in two of LGIM's index funds: one is designed to match the total return on the FTSE-RAFI Emerging Markets Equity Index; the second is designed to match the total return on the MSCI World Low Carbon Target Index. The MSCI World Low Carbon Target is based on capitalisation weights but tilting away from companies with a high carbon footprint. The FTSE-RAFI Index is based on fundamental factors.

***Performance attribution:*** The two index funds both tracked their benchmarks as expected, as shown in Table 2.

**Table 2**

| Q4 2017 | Fund | Index | Tracking |
|---|---|---|---|
| FTSE-RAFI emerging markets | 5.08% | 5.06% | 0.03% |
| MSCI World low carbon target | 4.60% | 4.62% | -0.03% |

Source: LGIM

***Portfolio Risk:*** The tracking errors are within expected ranges. The allocation of the portfolio, as at quarter end, was 82.4% to the MSCI World Low Carbon Target index fund, and 17.6% allocated to the FTSE RAFI index fund.

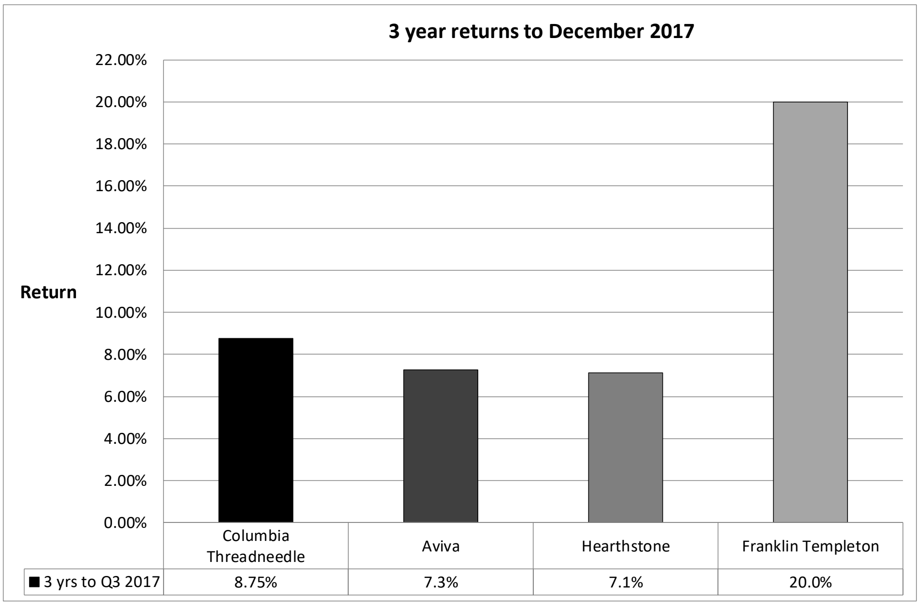
## 2.9. Franklin Templeton – Global Property Fund

***Headline comments:*** This is a long term investment and as such a longer term assessment of performance is recommended. There are two funds in which London Borough of Islington invests. The portfolio in aggregate delivered a return of +20.01% per annum over the three years to end December 2017, outperforming the absolute return benchmark of 10% per annum by +10.01% p.a.

***Mandate summary:*** Two global private real estate fund of funds investing in sub funds. The performance objective is an absolute return benchmark over the long term of 10% per annum.

***Performance attribution:*** Over the three years to December 2017, Franklin Templeton continues to be the best performing fund across all four property managers. Chart 7 compares their annualised three-year performance, net of fees.

**Chart 7**

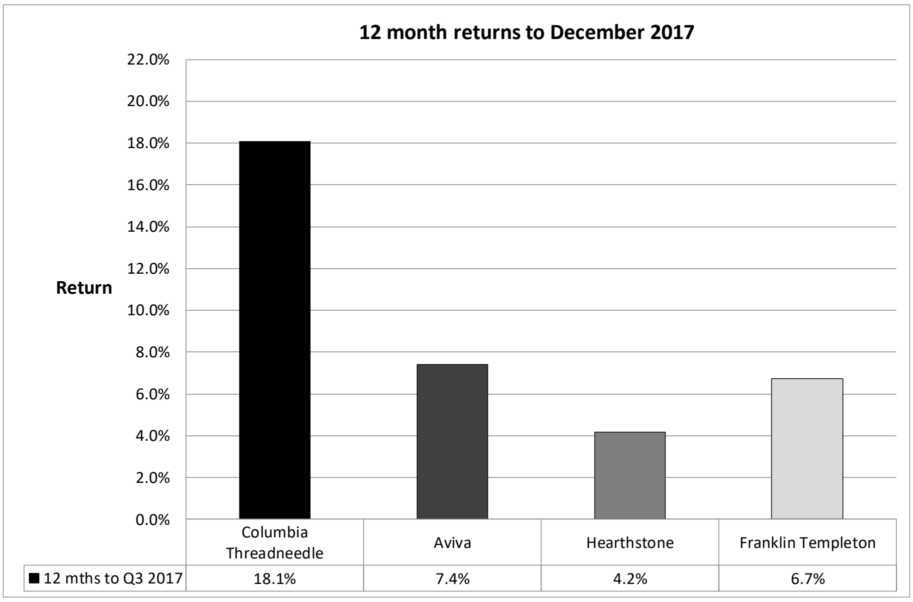


| | Columbia Threadneedle | Aviva | Hearthstone | Franklin Templeton |
|---|---|---|---|---|
| ■ 3 yrs to Q3 2017 | 8.75% | 7.3% | 7.1% | 20.0% |

Source: BNY Mellon

However, Franklin Templeton's more recent returns have meant that, over one year, Columbia Threadneedle is the leader, as shown in Chart 8.

**Chart 8**



| | Columbia Threadneedle | Aviva | Hearthstone | Franklin Templeton |
|---|---|---|---|---|
| ■ 12 mths to Q3 2017 | 18.1% | 7.4% | 4.2% | 6.7% |

Source: BNY Mellon

***Portfolio risk:*** as at end September (December figures not available at the time of going to print), the Franklin Templeton Private Real Estate Fund I had 51% leverage and Fund II had 47% leverage. Fund I had three investments that were substantially above target, four that were above target, five that were on target and two investments had issues. Fund II had one investment that was above target, three meeting expectations and three where it was too early to assess.

The two investments “with issues” in Fund I are: Sveafastigheter AB, which is in the final distribution phase, and Carlyle, which is in the process of being liquidated.

***Staff turnover/organisation:*** there were no changes to the real estate team in Q4, although in January 2018, just after the quarter end, John Levy joined the team as Director of Impact. John will be leading Franklin Templeton’s efforts to launch and grow impact investing strategies within their real assets platform, beginning with integrating impact management into the investment process for social infrastructure.

### 2.10. Hearthstone – UK Residential Property Fund

***Headline comments:*** The portfolio returned +1.44% compared to the IPD UK All Property Monthly Index return of +3.36% for the quarter ending December 2017. Over three years, the Fund delivered a return, net of fees, of +7.28% p.a. compared to the benchmark return of +6.53% p.a., an outperformance of +0.75% p.a.

***Mandate summary:*** The Fund invests in private rented sector housing across the UK and aims to outperform the LSL Acadametrics House Price Index (note that this excludes income), as well as providing an additional income return. The benchmark used by Bank of New York is the IPD UK All Property Monthly Index.

***Performance attribution:*** The Fund returned +7.28% p.a., net of fees, compared to the return on the index of +6.53% p.a. over the three years to December 2017, an outperformance of +0.75% p.a. The gross yield on the portfolio as at 30th December 2017 was 5.04%. Adjusting for voids, however, the gross yield on the portfolio falls to 4.77%.

***Portfolio risk:*** The cash and liquid instruments on the fund stood at 21.3% as at end December 2017, which is above Hearthstone’s target level of 15%.

It is worth noting that Hearthstone have launched a new, closed-end, 10-year fund which is now being directly targeted towards institutional investors (unlike the fund in which London Borough of Islington invests which is becoming increasingly targeted towards the retail market). The investment objective is very similar to the Property Authorised Investment Fund (PAIF) in which Islington invests, but there are some key differences:

- The average investment size is much larger, on average £8-12 million.
- It is a general UK housing fund ex London (the PAIF includes London).
- The PAIF is meant to replicate the index in asset allocation. Within the closed fund, asset allocation is active, and a key decision is not to invest in London.
- The return on the closed-end fund should be slightly better than the PAIF’s, because the fund does not need to hold cash. This avoids any drag on performance.

There are five LGPS funds who have committed to the new fund, four of whom are in the same pool, but none are London Boroughs.

***Portfolio characteristics:*** The PAIF has a 13% allocation to detached houses, 50% allocated to flats, 22% in terraced accommodation and 15% in semi-detached. The allocation to flats remains a significant overweight position relative to the Index (50% for the Fund compared to 17% for the Index).

As at end December 2017, the Fund stood at £56.5 million. London Borough of Islington's investment now represents 49% of the Fund. This compares with 72% at the start of this mandate in 2013.

***Organisation and staff turnover:*** During the quarter, Peter Beaumont, Executive Director, and Mark Drysdale, Joint Fund Manager, left the firm.

Hearthstone have created three new share classes for the PAIF. Two are new income share classes for retail investors, and the third is a feeder share class. The re-branding exercise for the retail market is now being scheduled for February/March 2018.

The rebrand will include renaming the fund "Homeinvestor.fund" and they will use the WealthKernel investment platform. Hearthstone's aim is still to build the fund up to £100 million over 12-15 months, with more significant flows by Q1 2019 ahead of the next tax year-end.

### 2.11. Schroder – Diversified Growth Fund (DGF)

***Headline comments:*** The Diversified Growth Fund delivered a return of +3.31% in Q4 2017. This compared with the RPI plus 5% p.a. target return of +2.27% for Q4. Over one year, the Fund's return was +8.72%, compared to the target return of +9.12%, behind the target over one year by -0.40%.

***Mandate summary:*** The Fund invests in a broad mix of growth assets and uses dynamic asset allocation over the full market cycle, with underlying investments in active, passive and external investment, as appropriate. Schroders aim to outperform RPI plus 5% per annum over a full market cycle, with two-thirds the volatility of equities.

***Performance attribution:*** In Q4 2017, Schroders' holdings in global, US, Japanese and emerging market equities made the largest contributions to equity performance (+2.9% in aggregate) with more muted contributions from fixed income (government bonds being the main contributor, adding +0.2%). Absolute return strategies also contributed +0.2% in Q4.

Over 12 months, the largest contributor remained global equities (+2.5%) and North American equities (+2.5%). The negative detractors were commodities (-0.2%) and currency forward contracts (-1.5%).

The return on global equities was +18.7% for the 12-month period, compared with +8.72% for the Fund (a 46.5% capture of the equity return). Over a full 3-5 year market cycle the portfolio is expected to deliver equity-like returns so there is considerable ground to cover over the next two years in order to achieve that.

***Portfolio risk:*** The portfolio is expected to exhibit two-thirds the volatility of equities over a full 3-5 year market cycle. The volatility of the Fund over the past 12 months was 3.1% compared with 5.9% for equities (roughly 50% of the volatility) so the portfolio is broadly on track.

***Portfolio characteristics:*** The Fund had 21% in internally managed funds, 36% in internal bespoke solutions, 8% in externally managed funds, 31% in passive funds and 5% in cash, as at end December 2017, very little change to the previous quarter. In terms of asset class exposure, 44.7% was in equities, 29.4% was in alternatives and 21.2% in credit and government debt, with the balance in cash.

Alternative assets include absolute return funds, infrastructure, property, insurance-linked securities, and private equity.

***Organisation:*** during the quarter, there were 50 joiners and 29 leavers in the UK business. Lyndon Bolton, the client relationship manager has announced his retirement from the end of February 2018, after 23 years at Schroder and 37 years in the financial services sector. Geoff Day, who has worked with Lyndon on the LGPS side of the business, will be taking on the relationship manager role for London Borough of Islington.

**Karen Shackleton**
**Senior Adviser, Allenbridge**
**12th February 2017**

This page is intentionally left blank

# LGPS CURRENT ISSUES

## NEWS IN BRIEF

### STOP PRESS - CARILLION

Construction giant Carillion has gone into liquidation threatening the loss of thousands of jobs. Carillion's problems were caused by losing money on big contracts and large debts being built up. Many LGPS funds are exposed to Carillion and it highlights the importance of employer covenant monitoring. We will be issuing a separate communication on the impact on LGPS funds and what funds can be doing to protect themselves.

### AUTUMN BUDGET

There was very little on pensions in the autumn budget, with no changes announced to the current pension tax regime. Indeed there was very little on individual savings, with the focus, as far as individuals are concerned, on housing. For institutional investors, the Government will clarify its investment guidance to support pension funds investing in innovative firms. The Pensions Regulator will clarify guidance on investments with long-term investment horizons.

IN THIS ISSUE

It was confirmed, however, that the Lifetime Allowance would increase (in line with inflation) to £1.03 million on 6 April 2018.

### SECTION 13 – WHERE DO YOU SIT?

We have been working with GAD recently on its Section 13 calculations in respect of the 2016 actuarial valuations – GAD's report is expected to be published in May-June this year. In advance of this, we will shortly be providing funds with our own interactive database that compares the results of the 2016 actuarial valuations on 'like for like' assumptions for all England and Wales LGPS funds. It will provide an initial indication of where each Fund may sit in the Section 13 Report along with some broader commentary around funding trends and recommended actions.

### BREXIT AND PENSIONS

While everybody will need to adopt a "watch and wait" approach on Brexit, funds should also take steps to understand the risks to employers, and where possible, take steps that anticipate and mitigate those risks.

Withdrawal negotiations between the UK and the EU have been underway since June 2017 year, focusing on the financial settlement (the "divorce bill"), the Irish border and the future status of EU citizens. EU negotiators have made it clear that progress on these key areas must be made before trade talks can start. If no negotiated agreement is reached by the "leave" date of 29 March 2019, the UK will cease to be subject to the EU treaties, no transition arrangements will apply and future trade will be, by default, on World Trade Organisation (WTO) terms.

Businesses will face major challenges over the loss of open borders within the EU and in many sectors non-trade barriers, such as "passporting" issues for financial service providers, may also be problematic. There is no certainty yet on anything, even possibly the final exit date. In the meantime, what does this mean for funds and employers, and are there actions to be taken?

A key concern for funds are the investments and it is necessary that you monitor the effects Brexit is having on investment markets. Brexit-related risk is seen as adding to actual and potential market volatility, although it is important to view this in the context of the overall risk landscape.

In addition, employer covenant should be a major focus. The impact of Brexit on the employer's prospects will depend on a wide range of specific circumstances including the sector the business operates in, its global trading patterns and its dependence on EU workers in its UK workforce. Funds should seek to engage with employers and attempt to understand, anticipate and where possible mitigate employer related risk.

Funds also need to be aware of key dates and announcements being made in the Brexit negotiations, particularly in relation to the 2019 actuarial valuations. Where Brexit developments have a material impact on investment markets or employer strength just before the contributions are due to be agreed and certified, it may be necessary to reappraise assumptions before going ahead.

## PUBLIC SECTOR PAY CAP

The National Employers (who negotiate pay on behalf of 350 local authorities) have suggested that the majority of Local Government employees should receive a 2% salary increase for 2018 and 2019. This would apply for employees earning over £19,430, with those earning less than amount receiving a higher increase. National Employers said that this offer would increase the national pay bill by 5.6% over the two years covered by the offer. In response, local government unions said they would put it to their respective committees for consideration.

## ACADEMIES GUIDE

An "LGPS Arrangements for Academies Guide" has recently been produced by the Department for Communities and Local Government (DCLG) and the Department for Education (DfE) and is intended for schools considering conversion to Academy status, Academy Trusts and Multi-Academy Trusts. The guide is not exhaustive but does contain advice as to where additional information can be obtained.

## FROM QUANTITATIVE EASING TO QUANTITATIVE TIGHTENING

After almost a decade of monetary stimulus, the world's major central banks are starting to gradually pull back, led by the US Federal Reserve (the Fed). In response to low levels of unemployment and robust growth, the Fed recently announced a plan to gradually normalise its balance sheet over the coming years (referred to as quantitative tightening or QT). In November, the Bank of England (BoE) implemented its first rate hike since 2007 and the European Central Bank (ECB) has announced a reduction in the rate of asset purchases from January 2018. The pace and scale of the shift from quantitative easing (QE) to QT will be critically important for markets in 2018 and beyond.

As a result we currently have a preference for floating rate assets and are discussing these with our clients. If you would like any more information on this please contact your usual Mercer consultant.

## STEWARDSHIP IN THE 21ST CENTURY

As the finance industry seeks to rebuild trust following the financial crisis, institutional investors increasingly need to recognize the importance of their role in acting as good stewards of the capital entrusted to them. This requires investors to have a clear set of beliefs in relation to environmental, social and corporate governance (ESG) issues as well as recognizing and managing systemic risks (such as climate change). An increasing number of investors will seek to reflect their values and to promote the social good when investing their assets.

For long-term asset owners, we are currently looking at three crucial components of a sustainable investment approach; a set of clear beliefs, strategic asset allocation consistent beliefs and consideration of the impact of climate change on the portfolio and ensuring that underlying managers integrate appropriate consideration of ESG issues within their investment processes. If you would like further information on how we can assist you in this area please contact your usual Mercer Consultant.

## PREPARING FOR LATE CYCLE DYNAMICS

The later stages of a credit cycle typically present a challenging environment for investors, offering lower returns and greater risks than the early or mid-cycle periods.

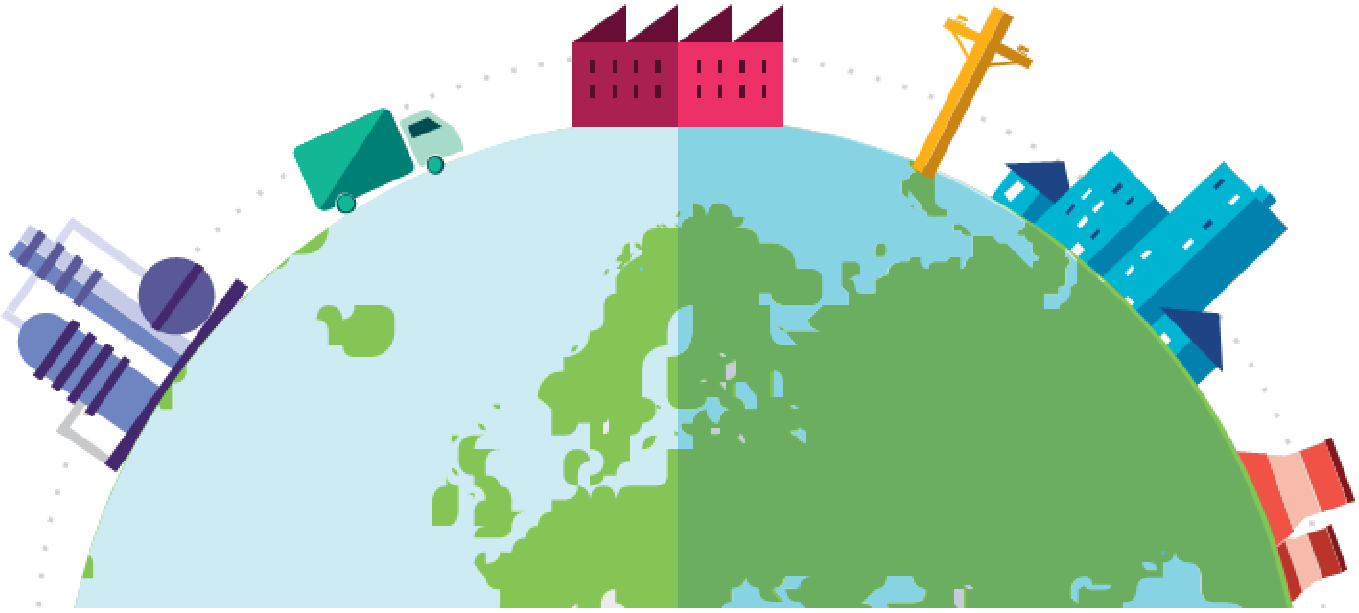
Although we expect the current economic strength (evident across much of the global economy) to continue into 2018, we believe that investors should start considering the ways in which they might prepare portfolios for the risks and opportunities that the late stage of this credit cycle might present.

## TIER 3 EMPLOYERS

The Scheme Advisory Board appointed Aon Hewitt to assist them in their review of Tier 3 employers in the LGPS (tier 3 employers do not have tax-payer backing; i.e. colleges, universities, housing associations, charities, admission bodies that do not have a guarantee from a Council, etc). The SAB released three surveys on 27 November for completion by LGPS Administering Authorities, tier 3 employers and LGPS members employed by tier 3 employers. The survey closed on 31 December 2017.

## UNISON CAMPAIGN

On the 10th of January, UNISON launched a campaign to encourage local government pension funds to divest from carbon and produced a step-by-step guide designed to help members of local government pension schemes push for changes in the investment of their funds. We are supportive of actions to integrate Environmental, Social and Governance (ESG) issues into the investment decision process. We prefer to assess the potential impact investment portfolios face from the transition to a low carbon economy. This involves not only assessing the potential negative impacts of carbon intensive industries, but also positively allocating capital to areas aligned with the transition to a low carbon economy. We have worked with clients for a number of years on integrating ESG into the investment process, and have produced a number of white papers on these issues including Preparing Portfolios for Transformation: Assessing the Prospective Investment Impacts of a Low Carbon Economy Transition.



# OTHER DEVELOPMENTS ON REGULATIONS AND CONSULTATION

## GENERAL DATA PROTECTION REGULATION

The GDPR introduces more stringent requirements than the existing UK data protection legislation. For example, individuals will need to give clear and affirmative consent for their personal data to be processed and there will be direct compliance obligations for data processors (such as scheme administrators), who will be liable for fines for non-compliance. The GDPR will apply directly to all member states from 25 May 2018.

The LGPC Secretariat circulated a legal opinion from the legal firm Squire Patton Boggs on 20 November 2017 regarding the implications of the EU's GDPR for the LGPS. The legal opinion is available here and includes the following:

- Whether member consent is needed to process the basic administration of the scheme
- Whether administering authorities can hold personal data when there is no remaining liability for an individual
- The legal power for administering authorities to share personal data with AVC providers
- The formal role each party has under GDPR – i.e. data controller, data processor or joint data controller

# DATES TO REMEMBER

| DATE | ISSUE | THE LATEST |
|---|---|---|
| 2018? | Tier 3 Employers | Outcome of the Tier 3 employers review |
| 2018? | Academies | Outcome of the academies review |
| 3 January 2018 | MiFID II | MiFID II becomes effective from this date. |
| 15 January 2018 | Scottish Regulations 2018 | Deadline for response to the Consultation |
| 31 January 2018 | Tax | Voluntary Scheme Pays Deadline |
| 1 February 2018 | Auto-enrolment | The final staging date for employers to enrol workers into a workplace pension. This completes the phased rollout of auto-enrolment. |
| 8 February 2018 | Base rate | The Bank of England's Monetary Policy Committee will meet to decide whether or not to change the base interest rate from its current level of 0.5%. |
| 13 March 2018 | Spring Budget | Chancellor of the Exchequer Philip Hammond will deliver the 2018 Spring Statement. |
| 31 March 2018 | Actuarial Valuation | Deadline for the 2017 Scottish actuarial valuation exercises to have been formally signed off by the Fund actuary. |
| April 2018 | Asset Pooling | LGPS funds must begin transitioning assets to the new investment pools |
| 5 April 2018 | Lifetime Allowance | Increase from £1m to £1.03m to match the Consumer Prices Index. |
| 25 May 2018 | Data protection | Date by which EU member states must comply with the new General Data Protection Regulation. |
| 13 January 2019 | IORP II | Date by which member states must adopt the new EU directive covering occupational pensions |
| March 2019 | Brexit | It is expected that the UK will formally leave the EU by the end of this month. |

# MEET SOME OF THE TEAM -

## THINGS YOU MAYBE DIDN'T KNOW

**Name:** Megan Fellowes
**Role:** Actuarial Technician Apprentice
**Joined Mercer:** April 2016
**Place of Birth:** Arrowe Park, Wirral
**Favourite Film:** Too many! All the Transformers/Fast & Furious'/Gladiator
**Dream Holiday Destination:** New York
**Favourite Christmas Present:** Earrings
**New Year's Resolution:** To be more fit and healthy!

**Name:** Mark Wilson
**Role:** Actuary, Public Sector Team
**Joined Mercer:** 2006
**Place of Birth:** Billinge, Merseyside
**Favourite Film:** The Bourne Ultimatum, Anchorman, A Few Good Men, Cool Runnings at Christmas!
**Dream Holiday Destination:** Hawaii but without the travel! It's my dream so can they move it to the North Sea?
**Favourite Christmas Present:** Individually wrapped bottles of IPA
**New Year's Resolution:** Trim beard more frequently

**Name:** Tim Birkett
**Role:** Covenant Consultant
**Joined Mercer:** 2010
**Place of Birth:** Leicester
**Favourite Film:** Terminator (not sure whether 1 or 2, definitely not 3 or 4 let alone 5)
**Dream Holiday Destination:** Peru then on to the Galapagos
**Favourite Christmas Present:** Amazon Firestick – so I can catch up on the Grand Tour
**New Year's Resolution:** Never to make resolutions – rather to make small lifestyle adjustments which will stick!

# CONTACTS

Paul Middleman
paul.middleman@mercer.com
0151 242 7402

Leanne Johnston
leanne.johnston@mercer.com
0161 837 6649

Ian Kirk
ian.x.kirk@mercer.com
0151 242 7141

Nigel Thomas
nigel.thomas@mercer.com
0151 242 7309

John Livesey
john.livesey@mercer.com
0151 242 7324

Clive Lewis
clive.lewis@mercer.com
0151 242 7297

Charlotte Dalton
charlotte.dalton@mercer.com
0161 837 6660

This edition of LGPS: Current Issues is for information purposes only.
The articles do not constitute advice specific to your Fund and you are responsible for obtaining such advice.
Mercer does not accept any liability or responsibility for any action taken as a result of solely reading these articles.
For more information about other training or advice about how any article in this issue relates to your Fund, please contact your usual Mercer consultant.
Mercer retains all copyright and other intellectual property rights in this publication.

Visit us at www.uk.mercer.com

Copyright 2018 Mercer Limited.  All rights reserved

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of:** **Corporate Director of Resources**

| **Meeting of:** | **Date** | **Agenda item** | **Ward(s)** |
|---|---|---|---|
| Pensions Sub-Committee | 21 November 2017 | | |

| | | |
|---|---|---|
| **Delete as appropriate** | Exempt | ~~Non-exempt~~ |

**Appendix A** is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information relating to the financial or business affairs of any particular person (including the authority holding that information).

# SUBJECT: The London CIV Update

## 1. Synopsis

1.1 This is a report informing the committee of the progress made at the London CIV in launching funds and running of portfolios over the period October 2017 to February 2018.

## 2. Recommendations

2.1 To note the progress and news to February 2018

2.2 To consider the LCIV governace restructure and strategy consultation document (attached as Appendix A- Exempt

2.3 To agree comments to the consultation document via question and answer document (attached as Appendix A1- Exempt

.

## 3. Background

### 3.1 Setting up of the London CIV Fund

Islington is one of 33 London local authorities who have become active participants in the CIV programme. The CIV has been constructed as a FCA regulated UK Authorised Contractual Scheme

(ACS). The ACS is composed of two parts: the Operator and the Fund.

3.2 A limited liability company (London LGPS CIV Ltd) has been established, with each participating borough holding a nominal £1 share. The company is based in London Councils' building in Southwark Street. A branding exercise has taken place and the decision was taken to brand the company as 'London CIV.' The London CIV received its ACS authorisation in November 2015.

3.3 **Launching of the CIV**

It was noted that a pragmatic starting point was to analyse which Investment Managers (IM) boroughs were currently invested through, to look for commonality (i.e. more than one borough invested with the same IM in a largely similar mandate), and to discuss with boroughs and IMs which of these 'common' mandates would be most appropriate to transition to the ACS fund for launch. Each mandate would become a separate, ring-fenced, sub-fund within the overall ACS fund. Boroughs would be able to move from one sub-fund to another relatively easily, but ring-fencing would prevent cross contamination between sub-funds.

3.3.1 Further discussions have been held with managers, focussing specifically on what would be achievable for launch, taking into account timing and transition complexities. Four managers have now been identified as offering potential opportunities for the launch of the CIV. These managers would provide the CIV with 9 sub-funds, covering just over £6bn of Borough assets and providing early opportunity to 20 boroughs. The sub-funds will consist of 6 'passive' equity sub-funds covering £4.2bn of assets, 2 Active Global Equity mandates covering £1.6bn and 1 Diversified Growth (or multi-asset) Fund covering just over £300m. Those boroughs that do not have an exact match across for launch are able to invest in these sub-funds from the outset at the reduced AMC rate that the CIV has negotiated with managers.

3.4 The Phase 1 launch was with Allianz our global equity manager and Ealing and Wandsworth are the 2 other boroughs who hold a similar mandate. The benefits of transfer include a reduction in basic fees and possible tax benefits because of the vehicle used. Members agreed to transfer our Allianz portfolio in Phase 1 launch that went ahead on 2 December.

3.5 **Update in January – letter from the Board**

3.5.1 The London CIV was formally established two and half years ago. Since then it has secured regulatory approval, established a team of 16 staff and by the end of this year will have brought £14bn of LLAs assets under LCIVs oversight. In the current year, there will be an annualised £6m of savings to the LLAs in management fees as a result of the work of the CIV. This puts the CIV some way ahead of the other pooled funds that are currently being established.

However the wider context has changed radically since London Councils took its decision to establish the CIV. In particular, the Government has decided that pooling should be mandatory across the country and have set an ambitious timetable for this to be progressed. The London CIV was very consciously set up as a voluntary scheme with the decisions on investment lying with the individual LLA pension funds.

In order to respond to this changed context and take stock of progress, a Governance review was undertaken last year jointly by LCIV, the Joint Committee (PSJC) overseeing the work of the CIV, and the LLA Treasurers. Willis Towers Watson was commissioned to lead the review and presented their final report to the Governance Review Steering Group in December.

The Towers Watson report pointed to the need to both clarify the purpose of the CIV and establish new governance arrangements that reflected this purpose. At present, the CIV is reporting to multiple different stakeholders in a complex way with the risk that none of them feel entirely satisfied with their ability to influence it. The report also recommended that the CIV strengthen its capacity to engage with individual LLAs.

The PSJC will consider its response to the report at its meeting on the 31st January. From discussions at the Steering Group, there is a fair degree of agreement on the changes to the governance that need to be made. As part of the discussion the PSJC will also receive a report on the alternative pooling models that have been set up so that we can compare and contrast them with the London model. LCIV have also reflected on what is the most effective approach to investment and engagement with individual LLAs going forward. Recommendations from this discussion will come to the Leaders' Committee in March. At the same meeting, the PSJC will have the updated Medium Term Financial Strategy and Budget for next year for the CIV to approve. The numbers put forward in it will be very much in line with the Strategy agreed last year.

LCIV is a start-up and has perhaps inevitably experienced some of the growing pains that go with this. Hugh Grover, who played a vital role in getting LCIV up and running has now stepped down and Mark Hyde-Harrison, a very experienced investment manager is covering the role on an interim basis. We will also be recruiting for a new Chief Investment Officer in the near future. In both cases it makes sense to complete the review work before undertaking this recruitment. The LCIV are confident that we can continue to make good progress.

London was a pioneer in establishing pooled arrangements and is consequently ahead of the rest of the country in this regard and LLA leaders played a key role in creating the LCIV. It makes sense to take stock now on how best to deliver the original vision for the CIV in the light of the wider changes that are happening on local authority pension fund management.

### 3.6 Consultation on governanace , investment and client communication

3.6.1 A full consultation document was circulated to boroughs on the 9th February attached **Appendix A – Exempt** and comments are expected by 28th February. The consultation covers governance, client communication and investment strategy and an excutive summary of the proposal is set out below.

3.6.2 The London CIV wishes to consult with LLAs throughout the first quarter 2018 to develop a sustainable pooling vehicle for London and is proposing the following initial Key Proposals:

- **Governance – Clearer Roles**
  In line with the discussions at the December PSJC, the London CIV will;
  - Host two General Meetings a year with all shareholders and disband the PSJC under the London Councils framework.
  - Form a small consultative shareholder group of 12 Treasurers and Pension Chairs.
  - Invite the Chair of the General Meeting onto the Board of the London CIV and a Treasurer as an observer.

- **Client – More Personalised Engagement**
  - A general service level agreement with the London CIV will be agreed. This would set out how the London CIV would service and consult with LLAs.
  - The London CIV would agree with each LLA individually:
    - The level of investment discretion delegated to the London CIV from three choices of Investment Mandate. This would allow the level of delegation to the London CIV to be personalised for each LLA.
    - A transition plan to agree a match of the strategic asset allocation of each LLA to the London CIV investment offering. The timing of the transition would be agreed to allow LLAs to either be early adopters or late adopters of Pooling.
  - A Responsible Investment Policy framework would be proposed by the London CIV and agreed by shareholders.

- **Investment – Greater Benefits (50bp p.a.)**
  - Develop blended investment mandates for core asset classes that have a number of managers in each fund.
  - Allow LLAs the option to grant investment discretion to the London CIV to gain greater efficiencies.
  - Offer Passive Trackers and a Liability Aware Fund as a low cost option.
  - Existing funds continue to be managed as normal.

- **Financial – No Change in Budgets in 2018**

### 3.6.3 Investment options and responsibilities

| Investment options | LLA Responsibilities | LCIV Responsibilities |
|---|---|---|
| Low Cost | LLAs invest in Passives (off-ACS) Equity fund investments<br>LLAs may select Liability Aware Fund themselves, or ask LCIV to assist<br>o LLAs manage the allocation between Equity and LDI, as well as the rebalancing between them | LCIV will ensure that passive funds are suitable and LDI manager is acting appropriately |
| Basic | LLAs retain responsibility for strategic and tactical asset allocation, cash management and rebalancing | LCIV develops Blended investment mandates in each core asset class (e.g. Equity, Fixed Income, Real Assets etc.)<br>• LCIV responsible for selecting and terminating underlying investment managers |
| Enhanced | LLA determines overall Strategic Asset Allocation and defines which other delegations it is comfortable affording the LCIV in an IMA. | • LCIV invests in the LCIV funds as in Basic option.<br>In addition the assets are managed in line with IMA. This might include for example:<br>• Tactical Asset Allocation (within ranges set by LLA)<br>• Rebalancing (frequency and range to be agreed by LLA)<br>• FX hedging<br>• Transition management<br>• Cash Management |

3.6.4 A questions and answer document attached **Appendix A1 –Exempt** has also been provided by LCIV to receive comments by 28th February .

3.7 Members are asked to consider the consultation document and feedback their comments to the LCIV.

3.8 **CIV Financial Implications- Implementation and running cost**
A total of 75,000 was contributed by, each London Borough, including Islington, towards the setting up and receiving FCA authorisation to operate between 2013 to 2015. All participating boroughs also agreed to pay £150,000 to the London CIV to subscribe for 150,000 non-voting redeemable shares of £1 each as the capital of the Company . After the legal formation of the London CIV in October 2015 , there is an agreed annual £25,000 running cost invoice for each financial year ..
The transfer of our Allianz managed equities to the CIV in December 2015 was achieved at a transfer cost of £7,241.

All sub-funds investors pay a management fee of .050% of AUM to the London CIV in addition to managers' fees.
In April 2017 a service charge of 50k (+VAT) development funding was invoiced and a balance of £25k will be raised in December once the Joint Committee has reviewed the in-year budget.
Members agreed to the 0.005% of AUM option for charging fees on the LGIM passive funds that are held outside of the CIV and agreed that (depending on the outcome of discussions) the same will be applied to BlackRock passive funds.
The Newton transition cost the council 32k.

## 4. Implications

4.1 **Financial implications:**
4.1.1 Fund management and administration fees are charged directly to the pension fund.

4.2 **Legal Implications:**
4.2.1 The Council, as the administering authority for the pension fund may appoint investment managers to manage and invest an equity portfolio on its behalf (Regulation 8(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

4.2.2 The Council is able to invest fund money in a London CIV fund asset without undertaking a competitive procurement exercise because of the exemption for public contracts between entities in the public sector (regulation 12 of the Public Contracts Regulations 2015). The conditions for the application of this exemption are satisfied as the London authorities exercise control over the CIV similar to that exercised over their own departments and CIV carries out the essential part of its activities (over 80%) with the controlling London boroughs.
.

4.3 **Environmental Implications:**
4.3.1 None specific to this report

4.4 **Resident Impact Assessment:**
4.4.1 The Council must, in carrying out its functions, have due regard to the need to eliminate unlawful discrimination and harassment and to promote equality of opportunity in relation to disability, race and gender and the need to take steps to take account of disabilities, even where that involves treating the disabled more favourably than others (section 49A Disability Discrimination Act 1995; section 71 Race Relations Act 1976; section 76A Sex Discrimination Act 1975."

An equalities impact assessment has not been conducted because this report is updating members on the implementation of a fund structure by external managers. There are therefore no specific equality implications arising from this report.

## 5. Conclusion and reasons for recommendations

5.1 The Council is a shareholder of the London CIV and has agreed in principle to pool assets when it is in line with its Fund strategy and will be beneficial to fund members and council tax payers. This is a report to allow Members to review progress at the London CIV and consider the current proposal on changes to governance structure, client communication and investment strategy.

**Background papers:**
Final report clearance:

**Signed by:**

| | | |
|---|---|---|
| **Received by:** | Corporate Director of Resources | Date |
| | Head of Democratic Services | Date |

Report Author: Joana Marfoh
Tel: 0207-527-2382
Fax: 0207-527-2056
Email: joana.marfoh@islington.gov.uk

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of:** **Corporate Director of Resources**

| **Meeting of:** | **Date** | **Agenda item** | **Ward(s)** |
|---|---|---|---|
| Pensions Sub-Committee | 5 March 2018 | | n/a |

| **Delete as appropriate** | Exempt | ~~Non-exempt~~ |
|---|---|---|

**Appendix 1** is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information relating to the financial or business affairs of any particular person (including the authority holding that information).

# SUBJECT- EQUITY PROTECTION STRATEGY- IMPLEMENTATION UPDATE

## 1. Synopsis

1.1 As part of the ongoing investment strategy update this report and Exempt -Appendix 1 reaffirms the objective of the Fund in implementing an equity protection strategy and updates on the final implementation service provider and structure.

1.2 Mercer our investment advisor, has prepared a presentation to highlight the main features of the implementation that will be presented to Members at the meeting.

## 2. Recommendations

2.1 To note the procurement and implementation schedule Table 1 (para 3.5.1)

2.2 To consider Mercer’s report Exempt Appendix 1- Equity protection strategy-Implementation

2.3 To receive Mercer’s presentation highlighting the main features and structure of the equity protection strategy

2.4 To agree to receive quarterly monitoring reports on the equity protection strategy.

## 3. Background

3.1 **March 2016 valuation**

The triennial valuation was completed in March 2017 with a calculated funding level of 78% and a deficit of £299m. A 22-year recovery plan was agreed with projected contributions over this period to achieve a 100% funding level

3.2 As at September 2017, the value of the fund was £1.32bn compared to the March 2016 position of £1.07bn. This will translate to a funding level of around 94% compared to 78% at the 2016 actuarial valuation. The improvement in funding level is mainly due to growth of assets versus expected returns. This increase is attributed to the rally in equity markets over the period and one cannot predict the future. Members at the last September meeting had initial discussions of an equity protection strategy and asked for a report to a special meeting to consider the strategy fully.

3.3 Members agreed at the October special meeting to implement an equity protection strategy aiming to protect 50% of the portfolio (total equities exposure is 65%). They agreed the protection will initially be to 31 March 2020, the next actuarial valuation and then reviewed.

3.4 Members then agreed at the November meeting that the strategy be financed by a premium in the region of £21m and that the Corporate Director of Resources, in consultation with the Corporate Director of Law and Governance and the Chair of the Sub-Committee, be authorised to proceed as swiftly as possible with the procurement process and appointment and due diligence to procure the services of a capable manager to protect the equity holdings in the Fund. Members also considered and agreed the Mercer provided long list of potential service providers.

3. 5 Officers and Mercer proceeded as agreed and a schedule of the process undertaken is shown in Table 1.

3.5.1 Procurement and implementation schedule-Table 1

| **Date** | **Process** | **Responsible officers/advisors** |
|---|---|---|
| 22/11/17 | Draft tender documents for consultation with Islington | Mercer/LBI officers |
| 27/11/17 | Tender documents sent out to long list providers of 5 with a 1 week turnaround | Mercer |
| 5/12/17 | Due diligence report and discussion to agree a provider and a proposed implementation structure. | Mercer/LBI officers and Allenbridge |
| 6/12/17 | Summary of discussion emailed to Chair/ Vice Chair | LBI officers |
| 15/12/17 | Meet LGIM team to discuss proposed structures and funding of premium | Mercer/LBI officers |
| 11/01/18 | Progress meeting with Chair | LBI officers |
| 18/01/18 | Meeting to discuss documentation and implementation | Mercer, LBI officers/LGIM |
| 19/01/18 | Agreed final structure with LGIM on consultation with Allenbridge | LBI officers/Mercer |
| 30/01/ 18 | Documentation completed and implementation confirmed for 1st -2nd February | LBI officers |
| 1/02/18 | Chair/Vice Chair briefed on final structure | LBI officers |
| | | |

3.6 The protection strategy was based on an equity notional value of £734m (equity value at 31 December 2017 less premium of £25m). The premium was sourced from our LGIM MSCI Global Low Carbon Fund. The target maturity is March 2020 except for Japan that expires in June 2020. The actual premium for the structure was £24.7m. The weighted average upper and lower strike were 94.9% and 78.3% respectively. A more detailed report is attached on the objectives and implementation structure Exempt Appendix 1 , and Mercer will make a presentation highlighting the key points.

## 4. Implications

### 4.1 Financial implications

4.1.1 The cost of providing independent investment advice and fund management is part of fund management and administration fees charged to the pension fund.

### 4.2 Legal Implications

The Council, as the administering authority for the pension fund may appoint investment managers to manage and invest a portfolio on its behalf (Regulation 8(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

### 4.3 Environmental Implications

Environmental considerations can lawfully be taken into account in investment decisions

### 4.4 Resident Impact Assessment

None applicable to this report. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding

.

## 5. Conclusion and reasons for recommendation

5.1 Members asked note the implementation process and schedule paragraph 3.5.1, consider the attached Mercer report- Exempt Appendix 1 and receive a presentation from Mercer highlighting the key points

**Background papers:**
None

Final report clearance:

**Signed by:**

Corporate Director of Resources Date

**Received by:**

Head of Democratic Services Date

Report Author: Joana Marfoh
Tel: (020) 7527 2382
Email: Joana.marfoh@islington.gov.uk

ISLINGTON

**Finance Department**
**7 Newington Barrow Way**
**London N7 7EP**

**Report of:** **Corporate Director of Resources**

| **Meeting of:** | **Date** | **Agenda item** | **Ward(s)** |
|---|---|---|---|
| Pensions Sub-Committee | 5 March 2018 | | n/a |

| | | |
|---|---|---|
| **Delete as appropriate** | | Non-exempt |

## SUBJECT: PENSIONS SUB-COMMITTEE 2018/19– FORWARD PLAN

## 1. Synopsis

1.1 The Appendix to this report provides information for Members of the Sub-Committee on agenda items for forthcoming meetings and training topics.

## 2. Recommendation

2.1 To consider and note Appendix A attached.

## 3. Background

3.1 The Forward Plan will be updated as necessary at each meeting, to reflect any changes in investment policy, new regulation and pension fund priorities after discussions with Members.

3.2 Details of agenda items for forthcoming meetings will be reported to each meeting of the Sub-Committee for members' consideration in the form of a Forward Plan. There will be a standing item to each meeting on performance and the LCIV.

## 4. Implications

### 4.1 Financial implications

4.1.1 The cost of providing independent investment advice is part of fund management and administration fees charged to the pension fund.

### 4.2 Legal Implications

None applicable to this report

### 4.3 Environmental Implications

None applicable to this report.  Environmental implications will be included in each report to the Pensions Sub-Committee as necessary.

4.4 **Resident Impact Assessment**

None applicable to this report. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life.  The council must have due regard to the need to tackle prejudice and promote understanding

.

## 5. Conclusion and reasons for recommendation

5.1 To advise Members of forthcoming items of business to the Sub-Committee and training topics

**Background papers:**
None

Final report clearance:

**Signed by:**

Corporate Director of  Resources	Date

**Received by:**

Head of Democratic Services	Date

Report Author: Joana Marfoh
Tel: (020) 7527 2382
Email: Joana.marfoh@islington.gov.uk

**APPENDIX A**

## Pensions Sub-Committee Forward Plan for March 2018 to March 2019

| Date of meeting | Reports |
|---|---|
| | Please note: there will be a standing item to each meeting on:<br>• Performance report- quarterly performance and managers' update<br>• CIV update report |
| | |
| 5 March | Equity protection implementation update<br>Presentation from the LCIV |
| 26 June | Training Policy Review<br>Business plan update<br>Annual Fund presentation – PIRC performance |
| 18 September | Alternative products to corporate bond portfolio<br>Actuarial funding update |
| 15 October | Pension annual meeting |
| 26 November | |
| 25 March | |

**Past training for Members before committee meetings-**

| **Date** | **Training** |
|---|---|
| 16 September 2014 | Investment in Sub Saharan Africa - 6.20-.6.50pm<br>Infrastructure - 6.55- 7.25pm |
| 25 November 2014 | Multi asset credit- 6.15-6.45pm<br>Real estate including social housing- 6.50-7.20pm |
| 9 March 2015 | Frontier Market public equity- 6.15 -6.45pm<br>Emerging market debt- 6.50- 7.20 pm |
| 11 June 2015 | Impact investing |
| 14 September 2015- 4.45pm pm | Social bonds |
| 13 June 2016 | |
| 21 September 2016 | Actuarial review training |

Proposed Training before committee meetings

| | |
|---|---|
| September 2018 | Asset backed securities |
| | |
| | |

# Agenda Item E1

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Document is Restricted

This page is intentionally left blank

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Document is Restricted

This page is intentionally left blank

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Document is Restricted

This page is intentionally left blank