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

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

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Appendix A is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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

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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 **<u>Update in January – letter from the Board</u>**

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.
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- **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 LLAs may select Liability Aware Fund themselves, or ask LCIV to assist 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.) • 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. In addition the assets are managed in line with IMA. This might include for example: • Tactical Asset Allocation (within ranges set by LLA) • Rebalancing (frequency and range to be agreed by LLA) • FX hedging • Transition management • 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.

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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:

Corporate Director of Resources Date

Received by:

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