Appendix A

LCIV Proposed Strategy for Consultation

January 2018

Contents

Introduction

- The Governance Review that was commissioned from Willis Towers Watson by the LLAs and the London CIV was presented at the PSJC in December 2017. The Review and feedback from shareholders indicated a need for the London CIV to change its Governance Arrangements and clarify its purpose and future strategy.

- The London CIV, formally established two and a half years ago, has brought £14bn of LLAs assets under LCIVs oversight. In the current year, there will be an annualised £6m of savings in management fees for LLAs which exceeds the cost of operating the CIV. However, the London CIV recognises that to date, while it has achieved a great deal, its current vision needs to be clearer and it needs to be delivered in a more compelling way for LLAs to achieve their objectives.

- This report aims to initiate a consultation with key stakeholders to clarify the purpose of the London CIV and set out the direction of its future strategy. Although the report proposes a considered vision of how the London CIV should operate, it does not purport to be a fully formed proposal and as such we welcome constructive engagement and feedback.

- A consultation process is therefore key to ensuring that the proposals are appropriate for London. The key steps in the Consultation process are set out on page 7 and it is hoped that this can be concluded by the end of the 1st Quarter 2018. This would then allow the London CIV to start building for the future.

“A Collective Investment Vehicle for London Local Authorities (LLA) Pension Funds which delivers broader investment opportunities and enhanced cost efficiencies than LLAs can achieve individually and overall better risk adjusted performance.”

Background

- The review by Willis Towers Watson indicated that the London CIV was in an “invidious” position and urgently needed to refresh its governance arrangements and clarify the mission of the London CIV and its future direction.

- The London CIV was initially set up as a voluntary arrangement and has faced a number of challenges in building a pooling vehicle for LLAs. A number of concerns have been raised:
  - The lack of transparency and communication by the London CIV with LLAs
  - The lack of clarity over future fund launches
  - The time required to launch funds
  - The level of LCIV staff turnover
  - Concerns over the capabilities of LCIV in managing LLA assets
  - The ineffectiveness of the various governance bodies
  - Concerns that real benefits will not be delivered to LLAs

- These concerns need to be addressed by revisiting how the LCIV will operate and engage with LLAs going forward. In particular the Board of the LCIV now wishes to consult on three key areas: **Governance, Client and Investment**:
  - The creation of effective supervisory arrangements to improve the channels of communication between LCIV and LLAs Pooling. – a **Shareholder** perspective
  - The needs of Local Authority Pension Funds to achieve their individual pooling objectives– a **Client** perspective
  - That in operating the Pool investment efficiencies are maximised wherever possible so that the benefits of fee savings and enhanced performance amounting to 50 bp p.a. are realised. – an **Investment** perspective.

- Importantly, the LCIV budget for 2018 remains unchanged as the LCIV Board believes that the changes outlined in this report can be achieved in 2018 within the existing financial framework.

Executive Summary

- The design of the London CIV was intended to provide London Local Authorities (LLAs) with a investment organisation to undertake Voluntary Pooling. Difficulties in executing this vision and the Central Government policy of mandated pooling mean that it is now appropriate to revisit the design of the London CIV.
- The need to clarify the vision and strategic direction of the London CIV has been recognised by both LLAs and the London CIV and there is now an appetite to find an effective and sustainable way forward to deliver Pooling alongside the benefits originally envisaged when the London CIV was established.
- 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

Consultation Process

- Governance Review Presented and wider review initiated
  - Governance Steering Committee 11th December
  - PSJC 11th December
  - London CIV Board 13th December
- 1st Consultation Cycle
  - Treasurer's Group 18th Jan
  - PSJC 31st Jan*
- 2nd Consultation Cycle
  - London CIV Board 14th February
  - Treasurer's Group 15th February
- Final Version
  - PSJC 14th March
  - Leaders 20th March*

Indicative Timelines of LCIV Proposal

- Detailed planning has not occurred so timelines are only indicative. However, we would aim to have the new arrangements operating by end 2018.
- Key milestones:
  - Complete consultation in 1st quarter 2018
  - Build out LCIV resources and operations during 2018
  - LCIV develops blended investment funds with first funds launched in 2018.
  - First LLA fully transitioned into LCIV by end 2018.
  - The blended investment funds would be further developed over 2019.
  - The transition of all LLAs to the LCIV could exceed two years as we begin to transition LLAs and expect to improve the pace with experience.

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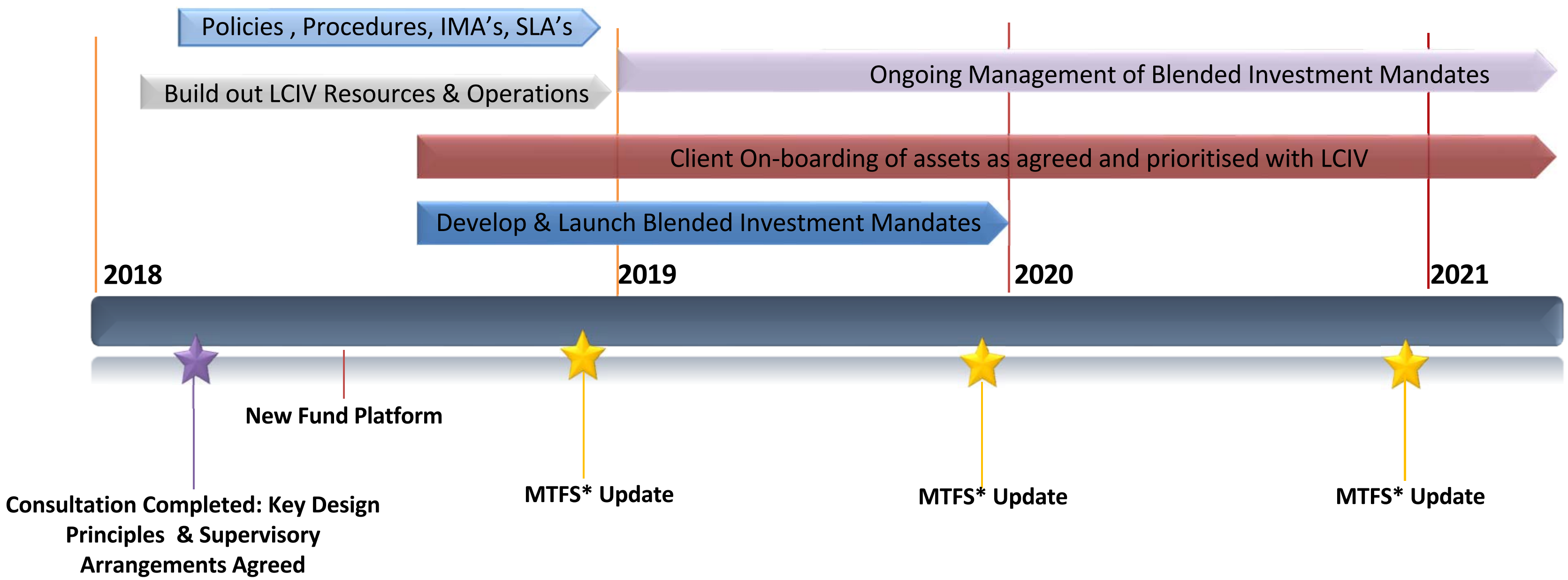


* Medium Term Financial Strategy

Governance

LCIV Governance

Key Governance Proposals

Shareholder

- A General Meeting of the London CIV will be held twice a year with all 32 shareholders plus a Chair, managed by London CIV. The meeting is to inform all shareholders on the performance of the LCIV and allow shareholders to exercise their rights under the Shareholders Agreement.

- A new 12 person Shareholders Committee will be formed of a mix of Treasurers and Members. The committee meets quarterly and will consult on strategy and allow shareholders to share issues and concerns with the LCIV Board. Chaired by the Chair of the LCIV.

- The London CIV Board is expanded with the addition of the Chair of the General Meeting. A treasurer will be an observer. The Board will continue to take decisions in the interests of all shareholders and seek to consult with shareholders before taking critical decisions.

- The Shareholder Agreement is not altered but continues to set out the responsibilities of the various parties. The arrangements are formalised by Terms of Reference of the General Meeting and Shareholders Committee.

Client

- The IAC becomes a forum to share ideas and consult with LLAs, when appropriate.

- The arrangements with LLAs are formalised via a Service Level Agreement (SLA) and, if appropriate, an Investment Management Agreement (IMA).

Proposed Governance Structure of London CIV

Annual General Meeting
32 Members plus a Chair
Meetings every 6 months

Exercise Shareholder powers
Hold Board to account

Shareholders Committee
12 Treasurers & Members
Quarterly Meetings

Consultation on strategy, direction and financial performance, Responsible Investment policy

Shareholder Agreement

Board

Independent Chair
5 NEDs
3 Executive Directors
Chair of AGM
Treasurer (observer)

Seminars, Manager Days Annual Conference

Local Authorities (Clients)

Service Level Agreement

IMA

Client on boarding, servicing, consultations, strategic asset allocation

London LGPS CIV Ltd

Funds

Equity	Fixed Income	Real Assets	Private Equity	Trackers + Liability Aware

Executive Committee

Investment Oversight Committee

Compliance Audit & Risk Committee

Remuneration Committee

Client

Client Engagement

The LCIV has operated to date on the basis that LLAs engagement with the LCIV is voluntary. This led to a client engagement model where the LCIV acts as a procurement vehicle with LLAs expressing their requirements via Working Groups. Central Government has now mandated pooling and we need to find a new engagement model that meets the investment objectives of all LLAs and the fact that LCIV was not formed with a set of common investment beliefs.

Given the wide range of LLAs investment objectives it is proposed that LCIV seeks to develop a personalised approach for each LLA.

- We therefore propose a new client engagement model where roles and responsibilities are clearly defined, and we establish a more formal and professional relationship.

  - A Service Level Agreement will provide clarity of roles and responsibilities, a clear mandate holding LCIV to account and alleviate some of your current responsibilities. LCIV will provide performance reviews, feedback on your investment mandates, and be available for committee meetings as required. Each LLA will have a named client relations director and client service executive for support.

  - If appropriate, an individual Investment Management Agreement (IMA) will be agreed between the LLA Pension Fund and LCIV setting out the level of investment discretion delegated to LCIV.

- LCIV will work closely with each LLA to map their Strategic Asset Allocation to the LCIV funds and determine the type of investment mandate the LLA prefers. A transition plan and the timing of the transition would be agreed to allow LLAs to decide to be either be early or later adopters of pooling.

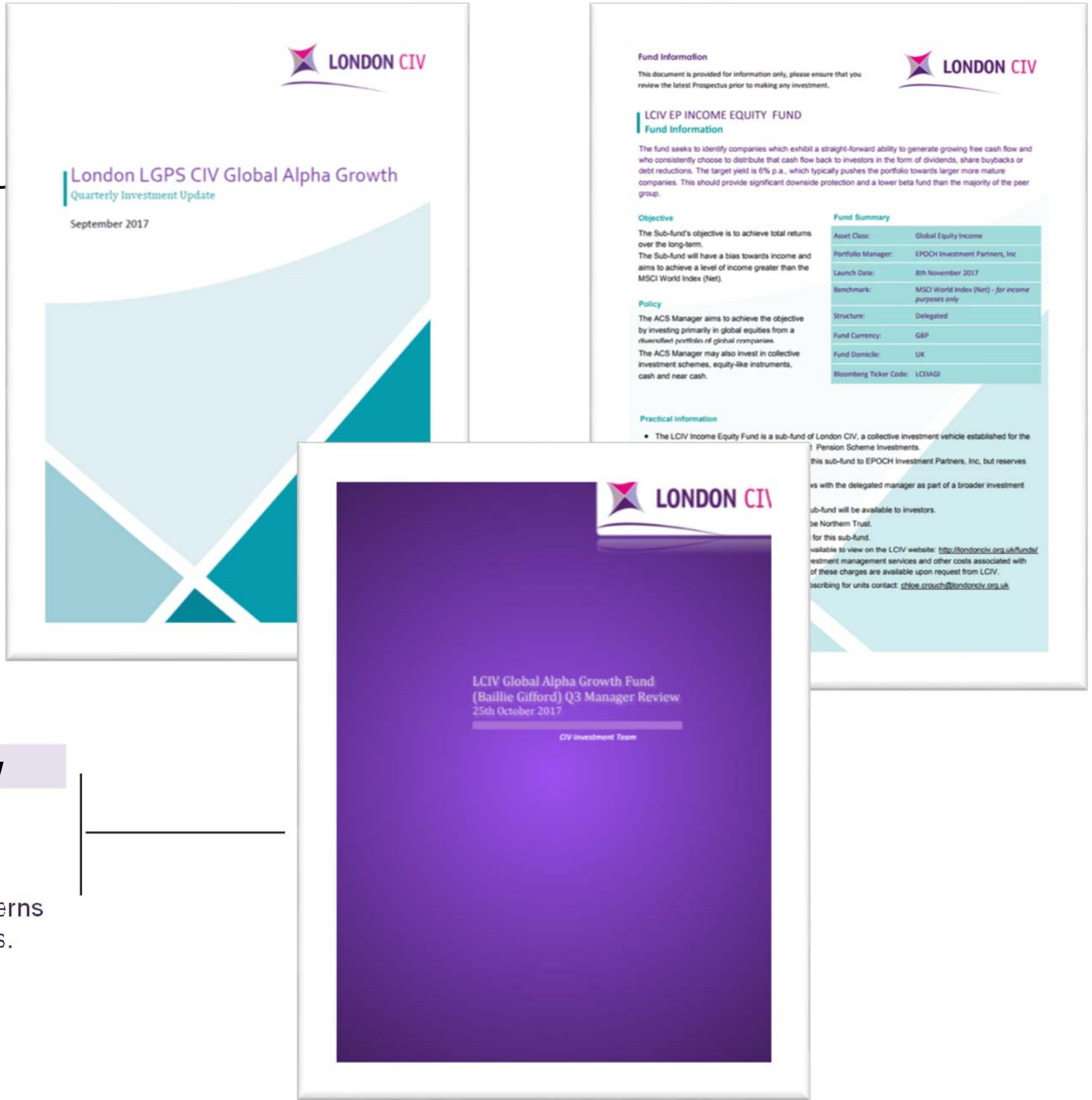
- To ensure that the LCIV understands the needs of LLAs, we would carry out regular consultations to determine future client requirements.

- The LCIV will not be able to accommodate individual ESG policies for each LLA. Instead it will propose a Responsible Investment Policy that will be laid before Shareholders at an AGM and then, if agreed, this will be binding on all LLAs.

Client Reporting: Sample of Reports

CIV Quarterly Report

- Commentary on your Personalised Investment Mandate via both qualitative and quantitative analysis.



Information Sheet

- Objective
- Policy
- Fund summary
- Practical information
- Key characteristics
- Top 10 Holdings
- Sector & Country Weights

Market Review

- LCIV Investment team review of current market conditions, concerns and opportunities.

Client Engagement Model

Named Client Relations Directors and Client Service Executives will be the principal London CIV contacts, who are available to respond to any queries, audits and FOI requests. They are available to attend Pension Committees and ad hoc meetings when required.

Weekly

- Market Information
- Calendar Dates of Events
- LCIV Portal provides daily/weekly prices for each fund
- Responding to queries, audit and FOI requests
- Attendance at Pension Committee & ad-hoc meetings

Monthly

- Newsletter
- Unaudited Fund Valuations available through the client portal
- Informal Investment Report Summary
- Information sheets for each Investment Mandate available on the client portal

Annually

- Shareholder AGM
- Due Diligence Reports on investment managers
- Voting report
- Responsible Investment report
- LCIV Investment Seminar

Quarterly

- Training Days
- Formal Investment Reporting
- Economic Update
- LCIV fees and expenses

On-boarding Model – Client by Client

The diagram below illustrates the on-boarding process for an individual LLA. We anticipate repeating this process 32x, prioritised and planned in consultation with the LLAs as we identify early and later adopters.

LLA provides timeframe

- LLA gives an indication of the likely time frame to transfer assets.
- LLA & LCIV agree prioritisation and dates of asset transfers.

LLA Consultation

- LCIV engages with LLA and maps Strategic Asset Allocation to LCIV Funds to ensure investment objectives are met
- Legacy LLA Assets identified and agreement reached on how managed going forward

IMA agreed LLA & LCIV

- LLA considers type of Investment Mandate given to LCIV
- If discretion given LLA & LCIV enter into an Investment Management Agreement (IMA)

LLA & LCIV SLA

Service Level Agreement (SLA) between LLA & LCIV

- Provides clarity of responsibility
- Clear mandate holding LCIV to account
- Free up responsibilities for LLA

LCIV manages transition

- LCIV manages transition of assets into funds to minimise transaction costs

LCIV manages Assets

- LCIV manages funds in line with Investment Mandate
- LCIV exercises discretion in line with the IMA
- Reports provided to LLAs on a monthly/quarterly basis

Investment

Investment Overview

The pools approach to investment is critical to the delivery of benefits. The scale of the benefits of pooling were investigated by Central Government and accepted to be significant enough to warrant making pooling mandatory. When discussions where taking place with Leaders to establish the London CIV PwC defined the benefits of pooling for London as an estimated saving of 15bp in fees and 35bp in investment outperformance.

In order to achieve the 50 bp p.a. of benefits it is important that the LCIV is given appropriate discretion in the management of the LLA assets. In particular, it needs discretion to be able to:

- Adapt to new investment approaches as they arise or as regulations change.
- Gain access to the full universe of investment managers.
- Have clarity and certainty over the size of the Investment mandate to negotiate fees.
- Minimise operational drag in implementing Investment decisions.
- Maximise visibility of cash flow so it can be managed efficiently.
- Maximise tax efficiency.
- Ensure efficient transitioning of assets across managers or asset classes.
- Ensure FX hedging efficiency.

Investment– Current Issues

- The current Investment model that was adopted is predominantly a **procurement platform**, with each LLA asking the London CIV to put a specific strategy or manager on the platform.

- The current investment approach has introduced a number of significant investment constraints:

  - **Access** to managers. It actually reduces access as the volume of money necessary for 32 different LLAs to reach allocation targets will automatically exclude certain investment opportunities and smaller managers.
  - **Inefficient implementation and launch process**. No fund can be launched without sufficient seed money from the LLAs. The lack of first mover advantage has meant that this seed money is often not readily forthcoming. This creates delays and potentially leads to high “opportunity costs”.
  - **Liquidity management.** Access to illiquid strategies can often lead to LLAs holding back cash for investment, which creates cash drag.
  - **Rebalancing**. A consistent, efficient rebalancing strategy which accounts for market liquidity is currently not available via the London CIV. This can lead to asset allocations significantly deviating from the strategic levels.
  - **Manager deselection.** The responsibility to decide to terminate a manager is unclear and potentially slow.
  - **Risk** There is no assessment on the risk consequence of adding a new manager to a LLA portfolio, so losing the benefits of recycling reductions in risk to generate greater returns.
  - **Lack of Accountability** of decisions can lead to poor outcomes
  - **Rigidity.** Inflexible fund structuring can exclude investment opportunities.

- Our assessment of the current model indicates that it will not achieve the 50bp p.a. target originally specified.
  - Almost no discretion has been granted to the LCIV to achieve the 35bp improved investment performance.
  - Fee savings should be achievable. Savings to date have been modest, though greater savings are expected in Fixed Income and Real Assets.

Investment Overview - Proposal

The Board proposes giving the LLAs **three flexible investment mandate options** that can deliver the full investment benefits originally specified when the London CIV was formed and would enable LLAs to meet their individual objectives.

The **three investment mandate options** proposed for consultation are;

- **Low Cost**: Passive Equity Funds and a Liability Aware fund.
- **Basic:** Blended Investment Mandates established across asset classes with the LLAs selecting fixed amounts in each according to their Strategic Asset Allocation.
- **Enhanced:** Blended and Low Cost Investment Mandates established with LCIV providing tactical asset allocation as opportunities arise. LLAs will be able to tailor the amount of discretion afforded to the LCIV in their individual IMA.

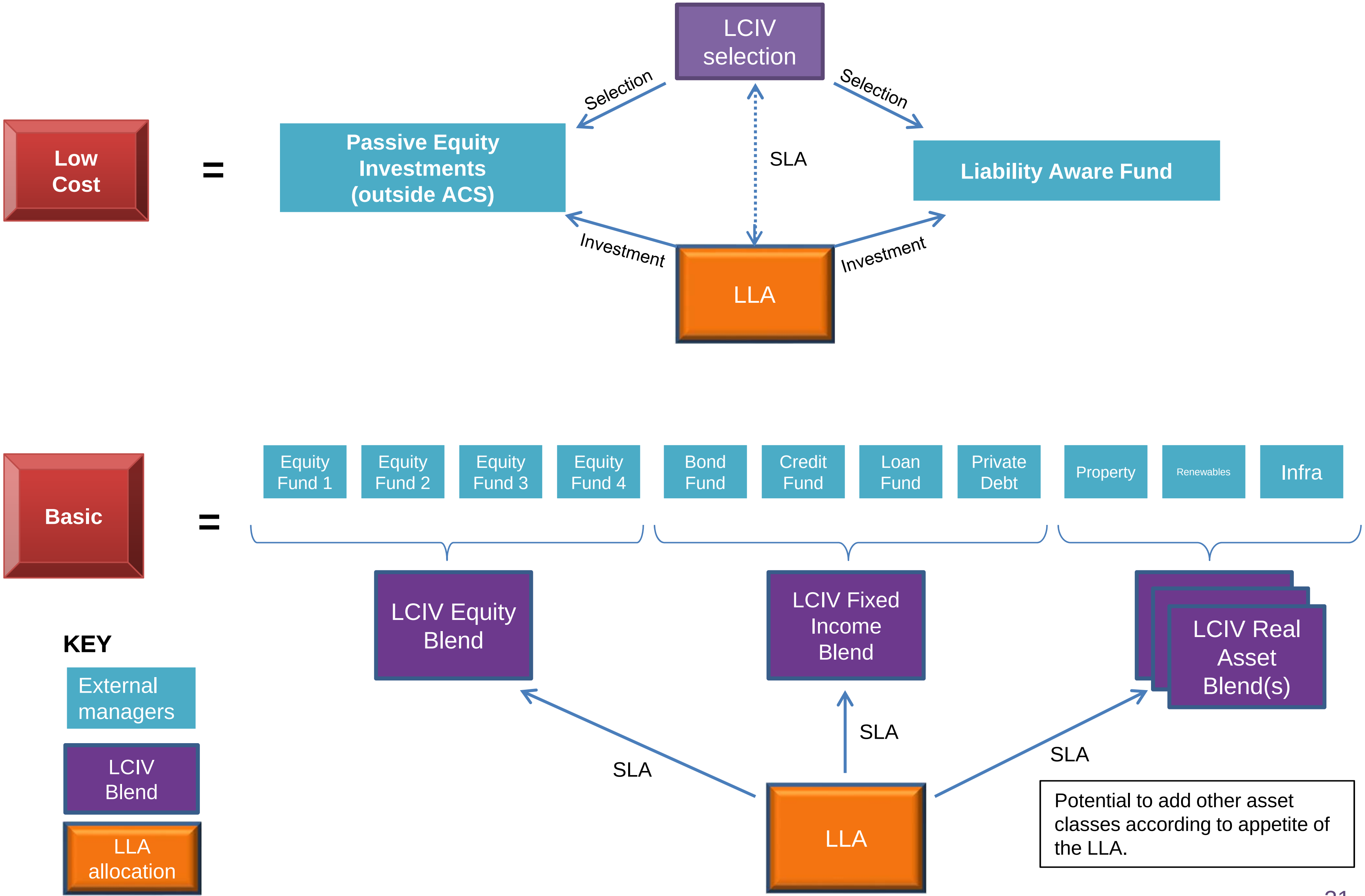
Each LLA can choose which option they feel is most suitable and appropriate for them and this may evolve over time. Every LLA will have a Service Level Agreement (SLA) with LCIV providing clarity of roles and responsibilities.

Three Investment Mandate Options

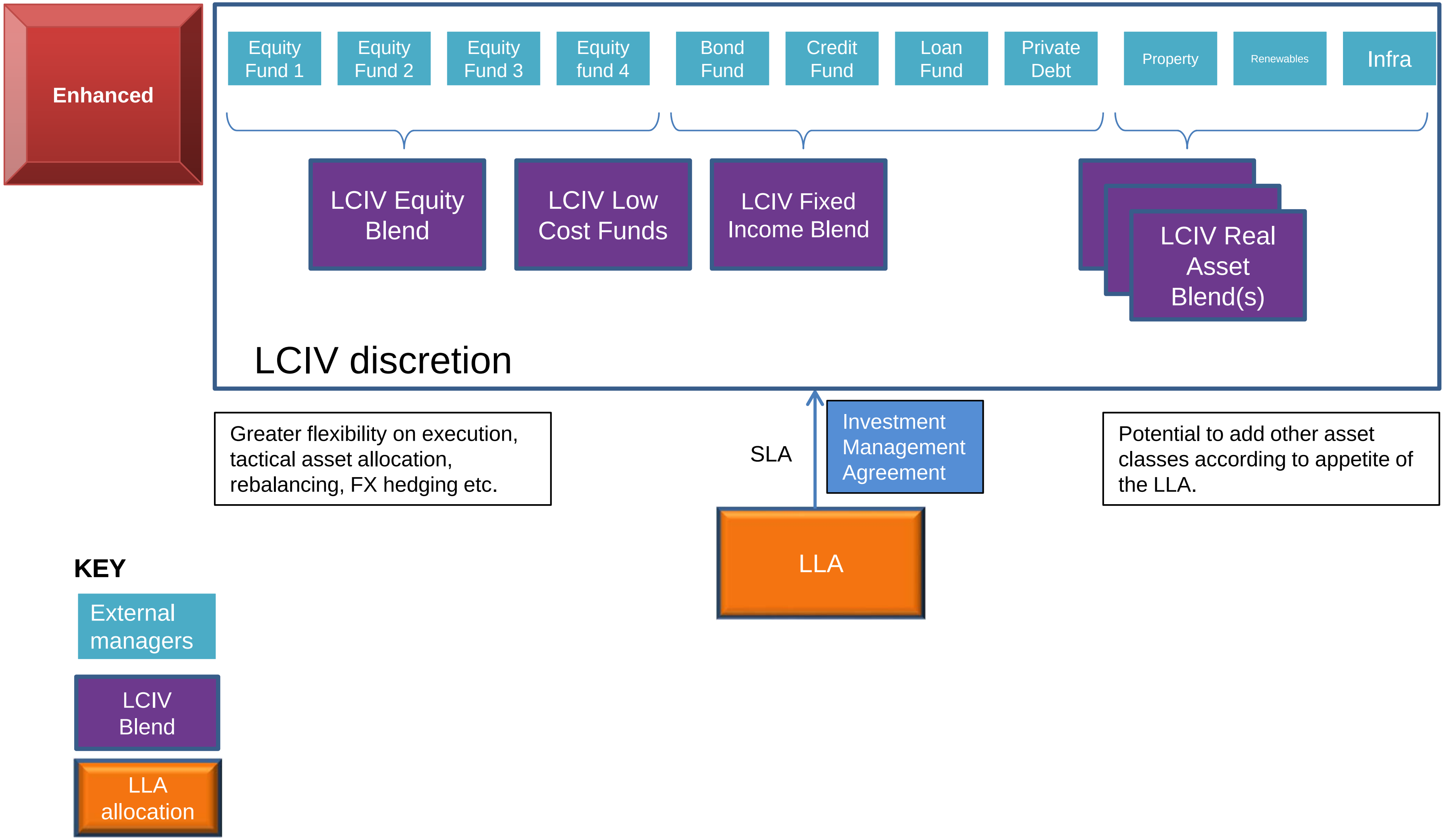
	LLA Responsibilities	LCIV Responsibilities
Low Cost	• LLAs invest in Passives (off-ACS) Equity fund investments • LLAs may select Liability Aware Fund themselves, or ask LCIV to assist • LLAs manage the allocation between Equity and LDI, as well as the rebalancing between them.	• LCIV will ensure that 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

Flexible choice: Three Investment Mandate Options



Flexible choice: Three Investment Mandate Options



Investment Model Options Overview

Key

Borough only, if possible

Potentially available, with caveats

Available

Levers	Explanation	Current Model	Low Cost	Basic	Enhanced
Rebalancing	Consistent and efficient rebalancing strategy				
Liquidity	Provision of liquidity to separate accounts and tailored strategies so minimise cash drag.				
Diversification	Well-diversified portfolios, built to fully utilise risk budget.				
Illiquid	Vintage diversification, secondaries, manager access, co-invest opportunities				
Manager termination	Consistent and efficient sell discipline and implementation				
Operational & Administration	Custody fees, implementation efficiency, Audit costs, transition costs, etc.				
Governance	Both in terms of fund manager governance and reporting to the LLAs				
Alpha	Speed of appointment and reallocation				
Probability of reaching 50bp outperformance target (net of LCIV costs).	Made up of 15bps fee savings + 35 bps investment outperformance	**20%** - fee savings largely negated by LCIV fees. Some investment outperformance but insufficient to meet target.	**20%** - cheapest option will lead to fee savings. Investment outperformance entirely dependent on individual LLAs.	**75%** - fee savings and investment outperformance achievable.	**95%** - fee savings and investment outperformance achievable.

LONDON CIV