London LGPS Collective Investment Vehicle (CIV)

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Background and Challenges

- Capital Ambition – PwC Report to London Councils on joint pension fund investing – Up to £120 Million per annum savings
- LPFA Challenge to merge funds
- Letter to the Times – Six LGPS Funds
- Deficit problems for some – Press/Michael Johnson "death spiral" claims
- London boroughs pressing ahead investigating voluntary CIVs through London Councils
- Ministerial Announcement in May 2013 followed by Call for Evidence
- Options – say Yes/No to merger or provide a viable alternative

First Step- To Find out where we are

All London Local Authority Pension Funds were asked to complete a survey to establish the following about the structure of their funds:

- Asset Classes
- Active or Passive, pooled or segregated
- Managers
- Mandate Size
- Benchmark and benchmark returns
- Individual Mandate Returns
- Fees (broken down by fee structure i.e. Flat, ad valorem, performance etc…)

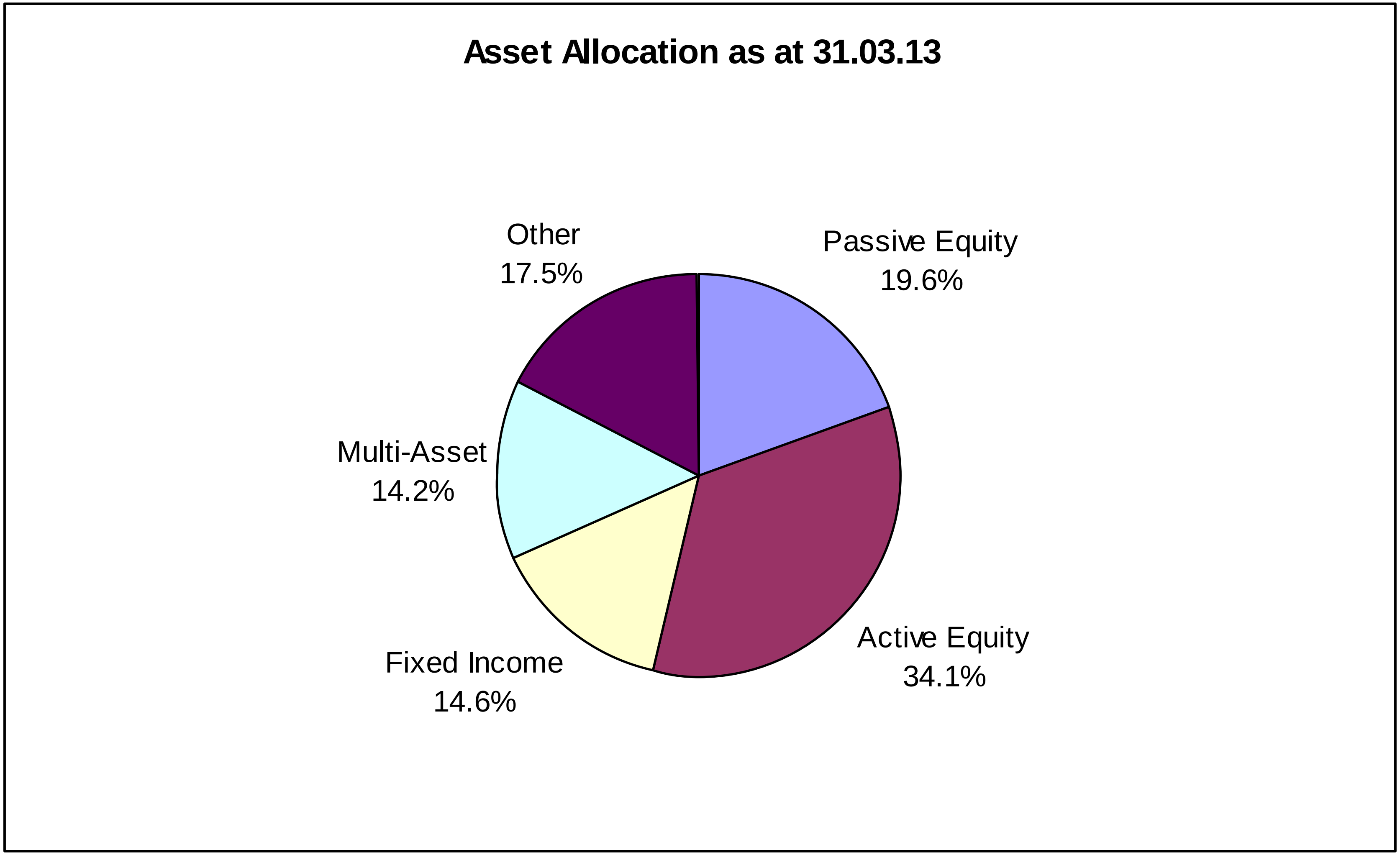
32 out of 33 of the London Boroughs completed the survey (some data cleaning was also required)

Headlines

DATA AS AT 31 MARCH 2013

- £22.9bn in funds under management
- £72.8m spent in fees in 2012-13
- Average fees paid across all asset classes was 32bps
- Fees ranged from 3bps to 200bps, with 3bps in one passive mandate and 200bps in a private equity mandate

Where do we Invest?



Who do we invest with?

- 253 mandates using 87 Fund Managers
- 5 firms have 36% of the business.

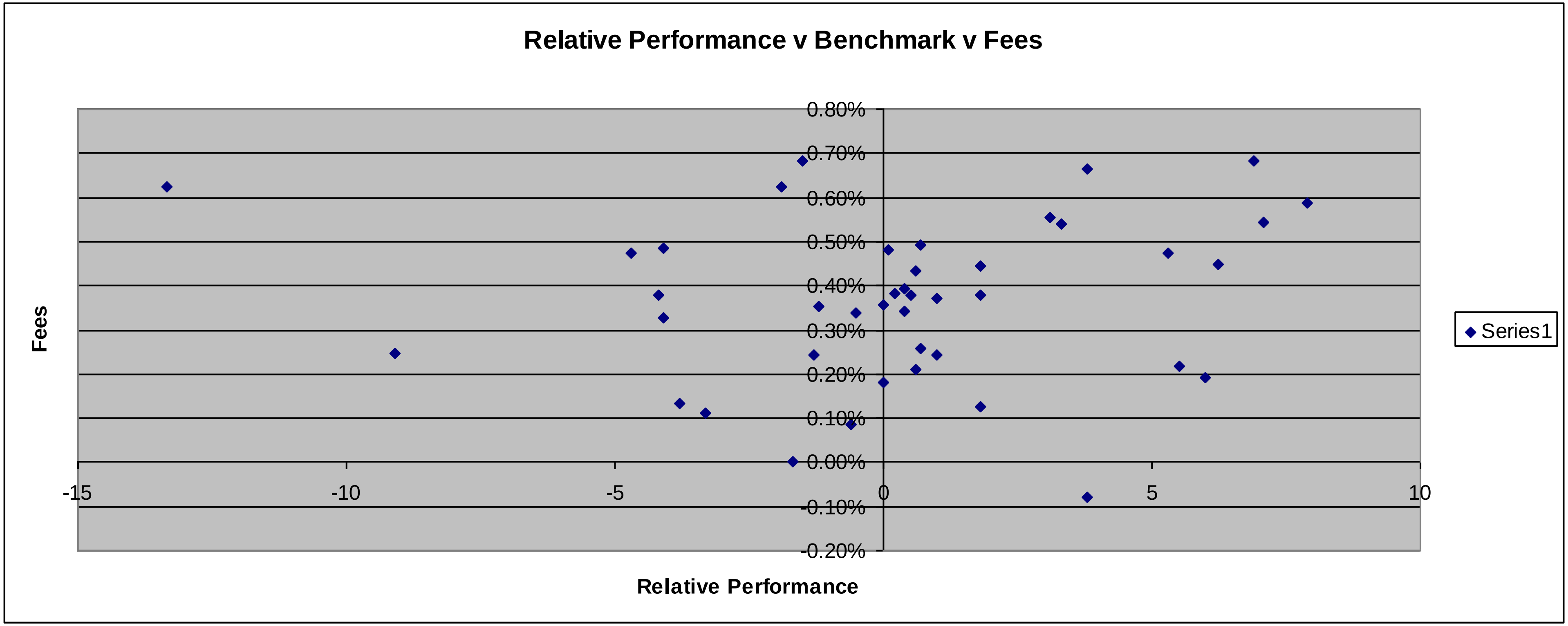
Passive Equity Funds

- 19.6 % of All Funds is invested in passive equity funds
- This ranges from 0% up to 89% of individual Boroughs funds
- 19 of 33 Funds have passive equity mandates
- The Average Fee differs depending upon territorial exposure as follows: UK Equity 6bps, Global Including UK 7 bps, and Global Excluding UK 13bps
- Fees range from 3bps to 16bps

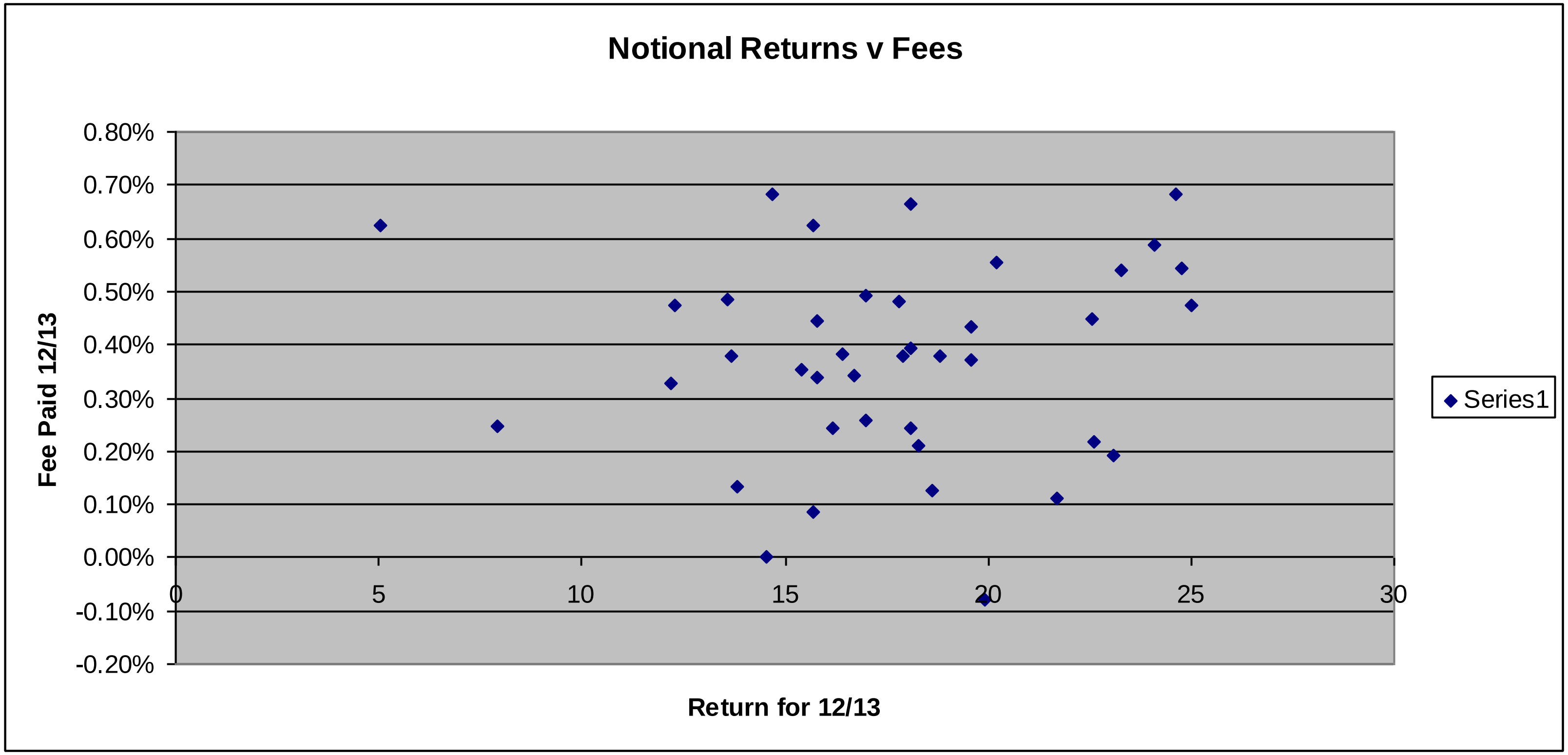
Active Equity Funds

- 34.1% is invested in active equity funds
- This ranges from 0% to 82% within each Borough's Fund
- Equity Fees range from 13bps to 68bps P.A. – The Average Fee for 12/13 was 33bps
- The average return over three years was 10.1% P.A.
- This ranged from 6.6% to 22.1% P.A.

Active Global Equity Fees vs Relative Performance to Benchmark



Active Global Equity – Notional Returns vs Fees



Other…(property, private equity, infrastructure etc…)

- 17.5% of funds are invested in other asset classes
- This ranges from 0.9% to 26% within each Boroughs Fund
- Fees range from 13bps to 200bps
- The average return over three years was 16.9% P.A.
- This ranged from 0.5% to 31.9% P.A.

Managers – Longevity or not?

Year	£'000s	Mandate Transitions
1983/84	87,571	1
1985/86	968	1
1990/91	17,956	1
1992/93	19,088	1
1995/96	308,574	4
1997/98	433,607	2
1998/99	425,561	4
1999/00	484,874	2
2000/01	328,644	3
2001/02	131,613	5
2002/03	1,470,373	9
2003/04	1,145,215	16
2004/05	1,206,827	12
2005/06	973,597	10
2007/08	1,511,788	16
2008/09	1,119,006	11
2009/10	2,333,770	21
2010/11	3,171,868	41
2011/12	1,079,211	16
2012/13	3,229,575	42

99 mandates changed in three years , is this reasonable ?

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SAVINGS FROM BETTER ACTIVE INVESTMENT

- The largest class of Active investing is Global Equity (Incl UK) - £4.976Bn, over half of all Global Equity exposure.
- If all participants had achieved just the 25th percentile returns then the boroughs would collectively be £49.4M net better off in 2012/13, but with some losers.
- However if only those that received performance below the upper quartile were to be brought up to the 25th percentile, while higher performers retained their returns, then the gain is £101.3M.
- Interestingly, the 25th percentile performance figure for 2012/13 of 17.45% is just over the one year return for most passive benchmarks.

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SAVINGS FROM PASSIVE AGGREGATION

- Total Passive Investments were £6.08 BN across UK Equity, Global Equity, Bond and Multi-Asset mandates
- Soft market testing on passive investment.
- All managers agreed that to get the lowest fees then it should be a ‘winner takes all’ scenario, i.e. one manager for all the passive strategies/asset classes adopted.
- Most managers noted it was important to distinguish actual investment management fees from the Total Expense Ratios, as well as ensuring stock lending income splits and other costs (FX, custody, brokerage) were captured in tender documentation.
- Clear indications that passive should be able to beat the index (probably by 10-20 bps before fees, but only sure once tendered) due to income from stock lending, efficient FX dealing, corporate actions, timing of individual transactions for index changes and sampling of index constituents.
- Even a modest saving (or increased return) of 5bp for boroughs passive assets would be £3,041,939 P.A. – More than enough to pay for running the CIV and increase returns.

Business Case

Assets under management	£24bn	£10bn	£5bn
	£ 000's	£000's	£ 000's
Expected savings per annum	120,000	50,000	25,000
On-going Costs per annum	(6,100)	(3,650)	(2,750)
Establishment Costs	(1,700)	(1,500)	(1,400)

- actual savings and costs will depend on the number of participating boroughs, amount of assets under management and the mix of investments

Summary

- Benefits even from passive collaboration
- Passive rather than active would have been better for many but some would want to remain active (Caveat – Short period of analysis and the past is no guarantee for the future)
- There is commonality among managers and mandates used = opportunities to combine and reduce fees
- Those funds getting the best returns do so consistently – Can that expertise be ported to the CIV for all to enjoy?
- High fees are payable in the alternative space – greater scale in a CIV will provide lower fees, greater control and diversification due to scale.
- THE NUMBERS SAY LETS DO IT!

The CIV – where are we now?

- The Pensions Working Group within the London Council's structure concluded that a CIV would be expected to produce significant cost savings and, overall, improved investment returns.
- The PWG recommendation to London Council's Executive was submitted to the December London Council's Leaders' Committee and agreed.
- That report set out proposals for taking forward further detailed work towards the establishment of a London LGPS CIV and particularly sought and received:

➢ Commitment in favour of establishing a CIV

➢ Agreement to London Councils being tasked with role of host body

➢ Agreement to the establishment of a fund, made up of borough contributions from those that wish to progress the proposals further

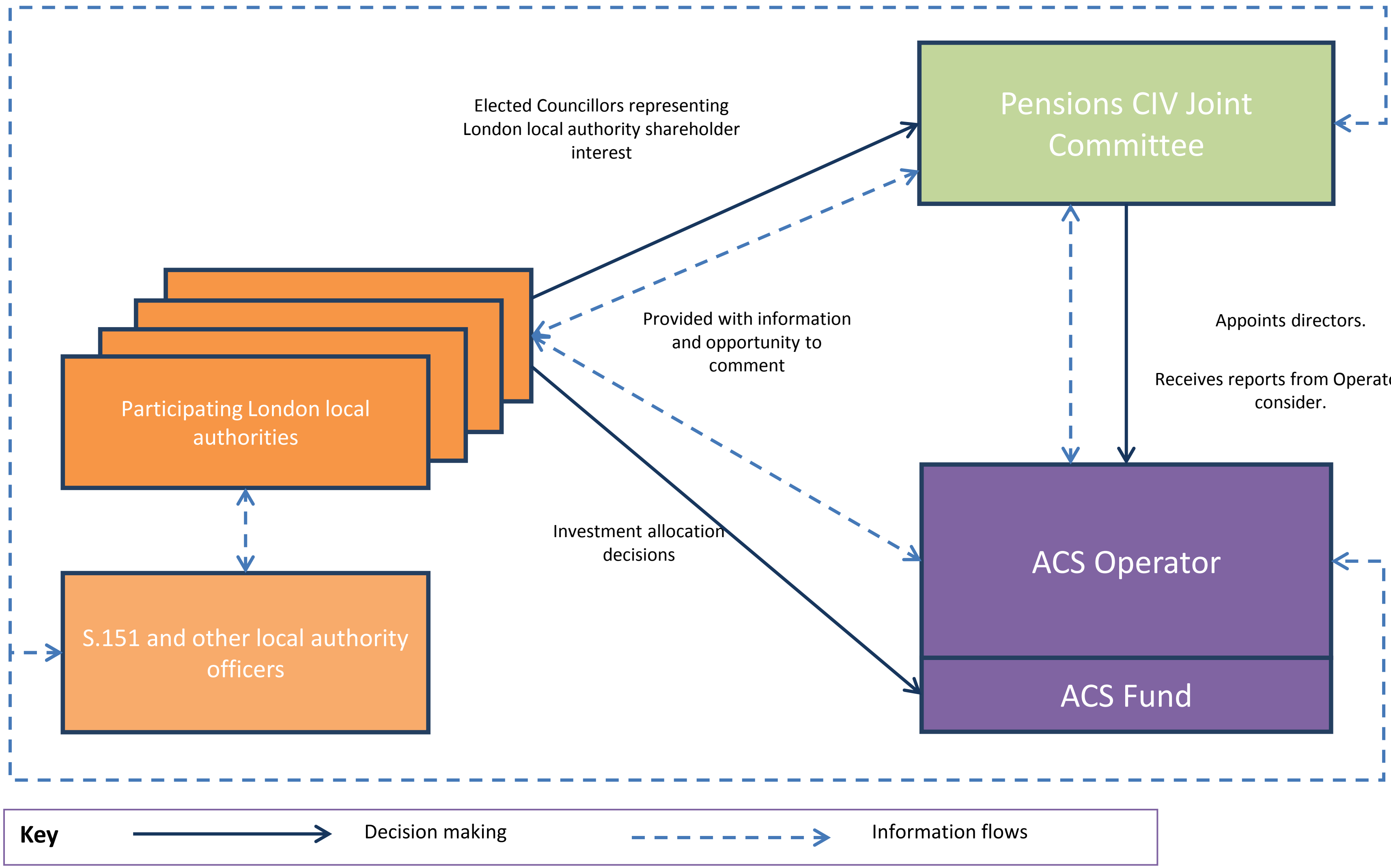
Cont… The CIV – where are we now?

- Borough Contribution anticipated to be £25k each
- All Boroughs except one have a degree of support of the CIV
- London Council's Leaders committee accepted in principle that the CIV is set up as an Authorised Contractual Scheme domiciled in the UK (Tax efficient and regulated)
- Scheme will be set up and launched with traditional asset classes such as equities, (passive/active strategies) and bonds
- Expand to cover alternative asset classes such as property and infrastructure as and when suitable investments are identified

The CIV – February 2014

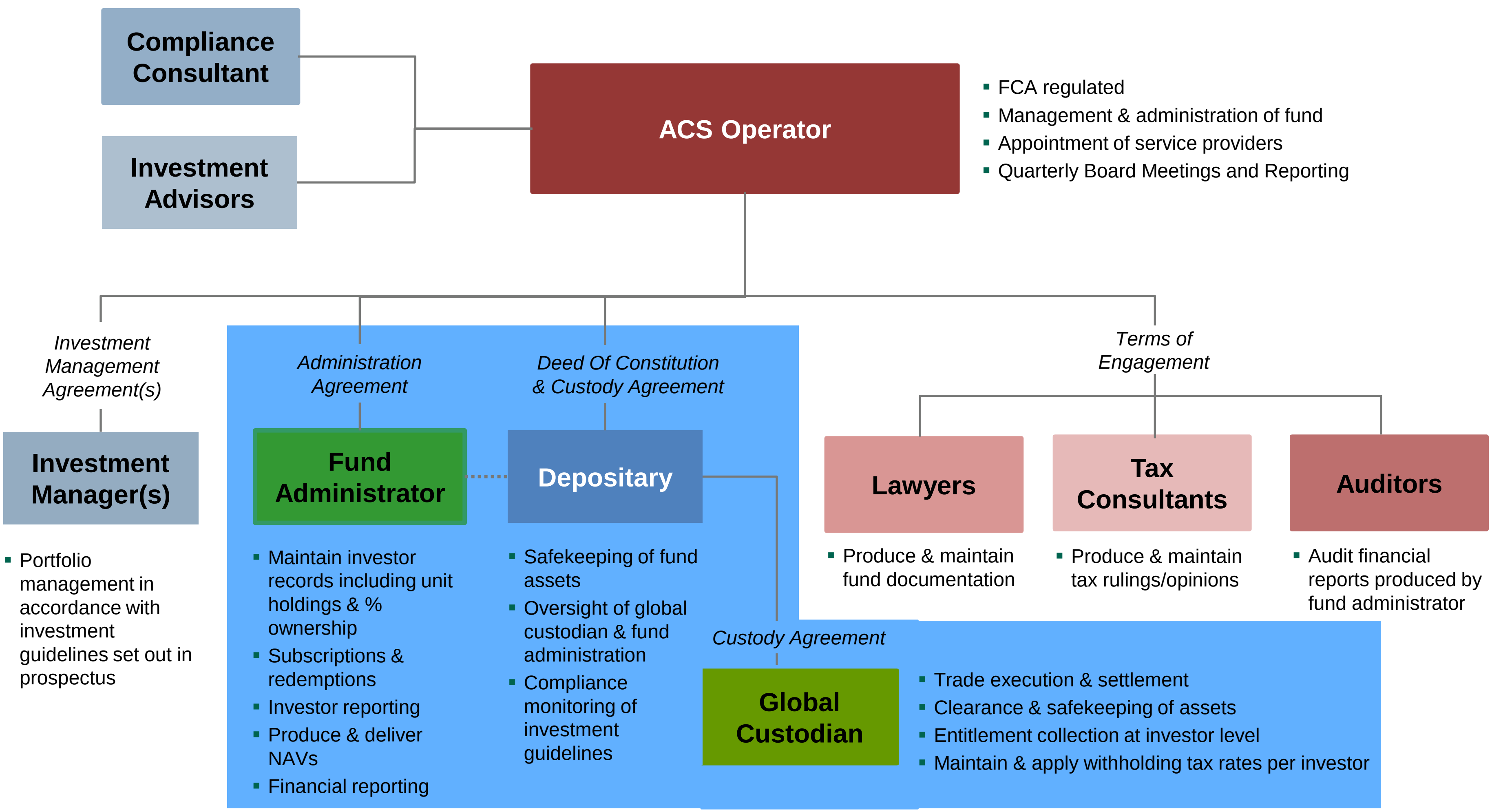
- Legal and financial advisers hired - business case and governance structures agreed by Leaders' Committee
- Implementation plan Agreed.
- Set up as ACS and get approved by FCA
- Await Government decisions.

Governance



Elected Councillors representing London local authority shareholder interest
Pensions CIV Joint Committee
Participating London local authorities
Provided with information and opportunity to comment
Appoints directors.
Receives reports from Operator to consider.
Investment allocation decisions
S.151 and other local authority officers
ACS Operator
ACS Fund
Key
Decision making
Information flows

ACS Operator



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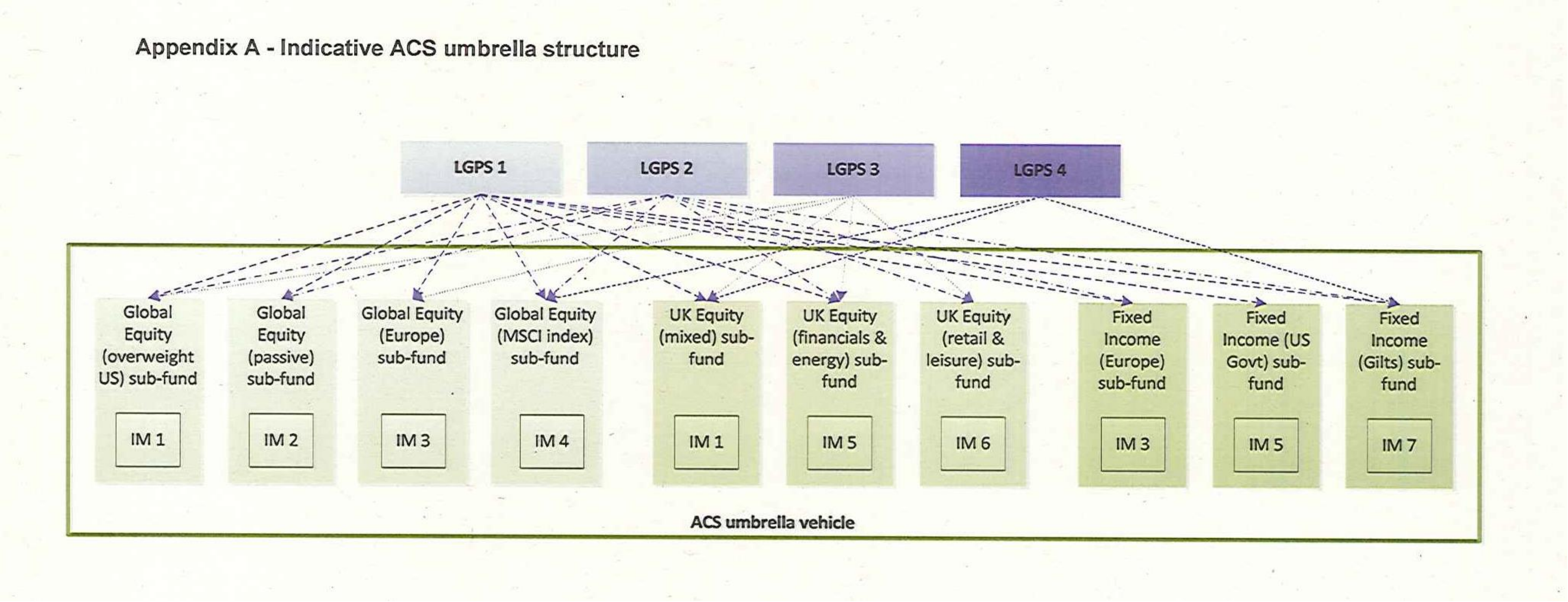
ACS Umbrella Structure



Decisions for London Borough Funds

- NOW
  - become a shareholder in a private company (the “ACS Operator”) of the Common Investment Vehicle;
  - contribute £1 to the ACS Operator as initial capital;
  - delegate to the Chairman of the Pensions Committee authority to act for the Council in exercising its rights as a shareholder of the ACS Operator,
  - agree to join the London Boroughs “Pensions CIV Joint Committee”, to be formed under section 102 of the Local Government Act 1972 and to delegate to those functions necessary for the proper functioning of the ACS Operator, including the effective oversight of the ACS Operator and the appointment of Directors.

Decisions for Boroughs

- LATER
  - Whether to invest or disinvest or just have this as an option?
  - What asset classes are we interested in?
  - What mandates we wish to join?
  - Do we wish to amalgamate one of our existing common mandates?
  - What alternative asset classes would we like the CIV to investigate?

Timeline

- April 2014 – Decisions made by boroughs
- June 2014 – New Company set up to be ACS Operator
- September 2014 – Put key outsource agreements in place (incl IMA's); engage with compliance consultants; draft policies and procedures; draft FCA application for Operator and ACS. During next 3-6 months gain approval from FCA
- February 2015 – Once FCA approved - Launch ACS

Questions

- Any Questions?