

Pensions CIV Sectoral Joint Committee

Item no: 5

Global Equity Procurement Update

Report by: Julian Pendock **Job title:** Chief Investment Officer

Date: 13 December 2016

Contact Officer:

Telephone: 020 7934 9887 **Email:** julian.pendock@londonciv.org.uk

Summary

The CIV Investment Team, working alongside the Global Equity Sub-Group (drawn from local authority colleagues of the Investment Advisory Committee (IAC)) has been progressing with the global equity procurement. In total some 57 clarification meetings were held with prospective fund managers, covering nine global equity strategies. A final preferred list will be discussed with the IAC and the Joint Committee. In addition, London Funds have been completing a survey to assess their current requirements in the global equity space, in order to decide which sub-funds should be opened first.

Recommendations The committee is recommended to:

- i. Note the contents of this report
-

Global Equity Procurement Update

Background

1. Members of the Joint Committee were provided with a brief update on the global equity procurement at the previous meeting of this Committee in October. As Members may recall, the rationale for focusing on this area was that this represented the largest single asset allocation decision for the London Pension Funds. So far two global equity managers have been transitioned on to the CIV platform, with a further two due to come on stream before the end of the financial year. It was clear from preliminary soundings that there was appetite for some new managers, particularly in strategies where funds did not currently have significant allocations, such as equity income and emerging markets.
2. Tenders were received from more than 200 fund managers. The Investment Team, along with the IAC Sub-Group and the Investment Consultants, assessed the submissions and produced a comprehensive short list. Submissions were evaluated on the basis of the following classification with the percentages allocated to each category:

Main Evaluation Category	Sub-Category Evaluation Criteria		
Philosophy, Process & Implementation (40%)	Idea Generation & Process	Portfolio Construction & Risk Management	Implementation
Business Management (20%)	Ownership Structure	People & Culture	
Track Record (10%)	Returns	Context	
Transparency & Reporting (10%)	Reporting		
Fees (20%)	Fees for £250m Mandate	Fees for £500m Mandate	

3. Clarification meetings were held with a total of 57 managers during October and November, which covered nine broad strategies.
4. Key points from the process:
 - **“New” names.** The potential size, as well as the profile of the tender, meant that managers not previously well-known to the LGPS (or little-known strategies from well-known managers) applied. In some cases, knowledge of some of these “new” names came from sources other than the investment consultants, e.g. CIV officers’ knowledge of the market and /or prior engagement with the managers. The inclusion of these names was welcome, and achieved the goal of spreading the net more widely.
 - **Scoring process and decision-making.** The clarification meetings proved to be appropriately named; in most cases, the meetings did clarify issues and questions which the Group (i.e. CIV officers and Global Equity Sub-Group) had identified. On occasions where they did not, a further written clarification was sought and circulated

to those involved in the relevant meetings. As a result, by the end of each day, the top three or four fund managers for each strategy had become evident.

- **“Ranking” the managers.** In some cases, the approach that each manager took for each strategy was different and therefore this made simple ranking more challenging, as it would be akin to comparing apples and oranges. Two examples of this would include the “Income” class, whereby the approach to managing factor risk, specifically duration risk, was key. Another example would be “Core”, a strategy defined more by what it is not than what it is, and therefore resulted in a range of approaches which were highly differentiated.
- **Number of managers for each strategy.** There is a trade-off between maximising the number of managers for each strategy in order to maximise choice, versus minimising the number in order increase scale economies and reduce time until launch, and oversight and monitoring costs. For each strategy, more than one manager has been taken through to the next stage (apart from Quality, which is already very well represented on the CIV). Ultimately it is preferable to have at least one manager in reserve, and certainly, much can change between now and onboarding, and therefore it is preferable to maintain some flexibility at this stage.
- **Good representation from the “decision makers”.** Again, given the profile of the tender, most (if not all) managers provided access to their key decision maker(s) for each strategy, regardless of the distance that the individual was required to travel. This added immensely to the quality of each clarification meeting. Ongoing access to key decision makers was emphasised as a criterion for selection.
- **Fees.** The indicated fees point to substantial potential savings. In many cases, further fee reductions would likely be sought as part of further negotiations, once a manager has been provisionally selected.
- **Combining (or blending) strategies: mainstream strategies, EM and Incubator.** The Global Equity tender process will offer Pension Funds the opportunity to spread their equity allocations across several strategies, thereby reducing specific strategy risk. Further, within each strategy, Pension Funds may also wish to have a combination of managers, given that some managers approach each strategy differently, and therefore a combination of managers can reduce manager risk. In both cases, there will be the opportunity to optimise the risk / return profile of the allocation, by diversifying risk.
- **Incubator.** Whilst all other lots are more self-explanatory, the Incubator strategy deserves more explanation. The idea behind incubator strategies is to identify funds / fund management companies which are at an earlier stage, but which by all (or most) measures except current AUM, would make it onto the full list (or, they are sufficiently differentiated and niche to be of interest in their own right). By investing at an earlier stage, boroughs would have access to capacity at a lower price than would be the case if and when the strategy were to mature, and at the same time ensure that promising fund managers were not caught out by the increasing difficulties of achieving critical mass. In sum, the relationship is symbiotic, and having such a facility is considered best practice in many large funds across the globe. Given the nature of these investments, LBs (should they wish to invest) may well wish to be able to access these as one “basket”, and therefore the CIV will be

engaging with the LBs in order to determine the optimal ways of accessing these funds.

5. Discussions took place with the equity sub-group after each clarification meeting and broad agreement was reached on the managers to be put forward to the next stage, subject to compiling the evaluation reports for each strategy and discussion with the IAC on finalising a list to be considered for appointment. Officers of the CIV are currently compiling detailed reports on each of the strategies and the managers and these will be presented to the IAC in December. Once the list of managers has been reviewed and agreed the intention will be to have “Meet the Managers” days, in order to gauge indicated interest in each manager.
6. Following review of the managers presented at the IAC, the IAC will then make recommendations to the Joint Committee on managers to be taken forwards. These recommendations will then be considered by the Board of the London CIV and final decisions taken on appointment.
7. The London CIV has also been conducting a survey of the London LGPS Funds to enhance current understanding of likely equity fund requirements which will help to determine which of the 9 strategies is put forward for development of new funds and the timeframe for doing so. Due diligence will be conducted on all the managers where sub-funds are going to be opened and commercial negotiations finalised.
8. London CIV is targeting opening the new global equity sub-funds in the summer 2017 with 3 planned as an initial phase, with a further 3 strategies opening in the autumn where demand arises.

Recommendations

9. The committee is recommended to:
 - i. Note the contents of this report

Financial implications

10. There are no financial implications for London Councils

Legal implications

11. There are no legal implications for London Councils.

Equalities implications

12. There are no equalities implications for London Councils

Appendices

Appendix 1 – Global Equity Investment Strategies

Appendix 2 – Global Equity Procurement Timeline

GLOBAL EQUITIES PROCUREMENT – INVESTMENT STRATEGY LOTS

Lot 1 – Generic Global Equities – 6 investment strategies:

- **Global Core** (Redington) - Exposure to long-only listed global equity markets with tilts to a blend of multiple style factors. This might include (but not exclusively); a combination of Value, Momentum and Quality factors.
- **Global Value** (Redington) - Exposure to long-only listed global equity markets with persistent style exposure to “value” factors (relative to the MSCI World). This might include (but not exclusively); low price to earnings, price to cash-flow or price-to-book ratios.
- **Global Quality** (Mercer) - Exposure to long-only listed global equity markets with persistent style exposure to “quality” factors (relative to the MSCI World). This might include (but not exclusively); high return on equity, high return on assets, low volatility of earnings growth or low levels of financial leverage.
- **Global Trend Growth** (global unconstrained) (Mercer) - Exposure to long-only listed global equity markets with persistent style exposure to “trending” factors (relative to the MSCI World). This might include (by not exclusively); price momentum, fundamental momentum or earnings revisions.
- **Global Income** (Mercer) - Exposure to long-only listed global equity markets with persistent style exposure to “dividend yield” (relative to the MSCI World), and a portfolio-level yield persistently in excess of the dividend yield on the MSCI World.
- **Global Low Volatility** (Redington) - Exposure to long-only listed global equity markets with a focus on creating a portfolio of securities that primarily target a lower overall volatility than MSCI World.

Lot 2 – Emerging Markets Strategy:

- **Emerging Markets** (Mercer) - Exposure to long-only listed emerging market equities with the majority of portfolio invested in securities listed in countries defined as “emerging”.

Lot 3 – Sustainable Equities Strategy:

- **Sustainable Equity** (Redington) - Exposure to long-only listed global equity markets with a focus on explicitly considering environmental, social and governance (ESG) factors in portfolio selection and management.

Lot 4 – Incubator Managers:

- **Emerging Managers/ Incubator** (Mercer and Redington) - Exposure to long-only listed global equity markets with firm-wide AUM less than \$2bn

Global Equity Timeline

