

# Leaders' Committee

## London CIV update

Item no: 4

**Report by:** Hugh Grover    **Job title:** London CIV Chief Executive

**Date:** 7 February 2017

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**Summary**                      This report fulfils the commitment of London CIV to provide updates to Leaders' Committee at regular intervals.

**Recommendations**      Leaders' Committee is recommended to:

- i. note the contents of this report;
- ii. reaffirm its on-going support for London CIV;
- iii. agree to the commissioning of a governance review and agree the attached Terms of Reference and Scope;
- iv. agree to the strategic direction set out in the budget and MTFS; and
- v. make a commitment to work collectively across London authorities to transition assets as swiftly and efficiently as possible.

# Leaders' Committee

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## London CIV Update

**Report by:** Hugh Grover      **Job title:** London CIV, Chief Executive

**Date:** 7 February 2017

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**Summary:** Leaders' Committee received its last update covering the progress of London CIV and the London LGPS pooling arrangements at its meeting of 9 February 2016. This report fulfils the commitment of London CIV to provide updates to Leaders' Committee at regular intervals.

Lord Bob Kerslake (London CIV's non-executive Chair) and Hugh Grover (London CIV's CEO) will be attending the meeting to discuss any aspects of the report.

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**Recommendations:** Leaders' Committee is recommended to:

- i. note the contents of this report;
  - ii. reaffirm its on-going support for London CIV;
  - iii. agree to the commissioning of a governance review and agree the attached Terms of Reference and Scope;
  - iv. agree to the strategic direction set out in the budget and MTFS; and
  - v. make a commitment to work collectively across London authorities to transition assets as swiftly and efficiently as possible.
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# London CIV Update

## Introduction

1. Since 2012 under the direction and leadership of London Councils Leaders' Committee, and in close collaboration with colleagues across London's local authorities, London CIV (LCIV) has been established to provide a wide range of financial and other benefits to the Local Government Pension Scheme funds of London local government.
2. London Councils' Leaders' Committee and Executive have been provided with reports at appropriate moments since 2012 as listed in 'Background Papers' below. The last update to Leaders' Committee was given at its February 2016 meeting.
3. This report provides a further update and comes to the committee at this time because LCIV is at a critical moment in its development requiring collective support for the for the organisations business plan and strategic direction for the next five years as set out in the attached budget and MTFS.
4. In December the Chair and CEO of LCIV, accompanied by leading Members from the London Councils Pensions CIV Sectoral Joint Committee, and a representative Treasurer met with the Minister for Local Government (Marcus Jones MP) to discuss progress and plans for LGPS pooling across London. He was supportive of what has been achieved and the general direction of travel, but pressed for faster transition of assets (see attached follow up letter and Lord Kerslake's response). Our plans set out a baseline for growth of the fund but also suggest that a more ambitious target might be achievable, but to deliver the ambitious target will require collective commitment.

## Progress

5. London CIV has been the 'trail blazer' for LGPS pooling and is a massive achievement for London local government. It was authorised by the Financial Conduct Authority in autumn 2015 as the first regulated investment management company set up and wholly owned by local government in the UK.
6. Since reporting to Leaders' Committee in February 2016 London CIV has continued to make significant progress, albeit not entirely as anticipated or at the scale that was at first envisioned, key elements of that progress are:
  - All 33 London local authorities (LLAs) are now members of the CIV arrangements, making this one of, if not the, biggest collaborative ventures in local government, and each has contributed equally to the costs of implementation.

- The fund has grown from its starting point in December 2015 of one sub-fund with £500 million of assets under management (AUM) to six sub-funds with £3.3 billion of AUM. These sub-funds have been developed on the basis of commonality (multiple LLAs invested with the same fund manager in the same product) and with a view to delivering fee savings from the aggregation of assets. The six sub-funds are estimated to be delivering £1.48m of net annualised fee savings across 17 invested LLAs. There are a further three sub-funds based on commonality to open in the spring subject to successful conclusion of discussions with the relevant fund managers. This will increase AUM to approximately £4.7 billion and deliver net annualised fee savings of £3.5 million across 19 boroughs.
  - A large part of LCIV's fund development plan was based on bringing passive equity investments on board. However, despite best endeavours, technical challenges and a major reduction in fund manager fees in this area led to the decision to leave these assets outside of the CIV, at least for the time being. Nonetheless, London CIV's work with the fund managers has delivered an estimated £2.4 million of net annualised fee savings across 15 LLAs. A major downside to this is that London CIV is currently not receiving any fee income from these funds, but there is a weight of opinion that the benefiting LLAs should pay a fee, albeit a relatively small one, and proposals are being worked up for discussion with LLA colleagues.
  - The focus of fund development is now moving away from opening commonality based sub-funds to procuring entirely new mandates. This is beginning with a range of new global equity sub-funds and will move on to fixed income products later in the year. This work is being taken forward in close collaboration with LLA colleagues through working groups of the Investment Advisory Committee, which operates under the leadership of representative LLA Treasurers.
7. London CIV has reached a pivotal moment in its development, passing from implementation of the basic structures and early sub-funds into a development phase before, in two or three years, we will reach 'business as usual' mode. The continued support of LLAs over the next few years is critical to achieving the long term benefits that can and will be delivered.
  8. The first year of operation has identified a number of key lessons and it is clear that the envisioned task that had been the basis for structuring ambitious delivery plans in 2015 is more challenging than anticipated and will require more up front 'spend to save' investment to achieve. Those lessons include:

- Being 'first mover' has associated research and development costs;
- Opening a sub-fund takes longer and is more complex than expected;
- More in-house resources and experience are required, and sooner than planned;
- Accurately predicting the timing or scale of asset transfer from each LLA is not possible as decisions about when and how much to transition remain sovereign decisions for each individual LLA pension fund.

9. Immediate challenges that London CIV's Board and Executive team are addressing include:

- Growing the organisation to ensure that we are fit for purpose and able to fulfil our regulatory responsibilities, fulfil the commitments we have made to LLAs to deliver benefits, and address the government's pooling criteria;
- Expanding resources rapidly and in an efficient manner to support the planned growth;
- Establishing realistic forecasts for AuM growth and related management fee revenue which are dependent on LLA asset transition plans; and
- Gaining full support and traction from the LLAs for LCIV's budget and development plans.

### **2017/18 Budget and Medium Term Financial Strategy**

10. Attached for information is London CIV's proposed 2017/18 budget and medium term financial strategy (MTFS) through to March 2022. This has been developed by the Executive team in consultation with the Board, lead Members from the London Councils Pensions CIV Sectoral Joint Committee, and a reference group of LLA Treasurers. It reflects the knowledge and experience gained over the first year of operating and seeks to address the immediate challenges with a view to establishing a robust, efficient and credible organisation.

11. Headlines from the budget are:

- Open more sub-funds through 2017/18 with the aim of having at least £6.3 billion of AUM by the end of the year, and plans to continue opening funds with a target of at least £14.1 billion AUM by the end of the MTFS period;
- Increasing headcount from the current base of 11 to 25 over the period;
- Introducing a £75,000 development funding charge for 2017/18, which will reduce

in future years as AUM grows and more income is generated from fees linked to sub-funds. This charge will allow LCIV to continue to develop without being completely reliant on AUM in the short term;

- Develop systems and processes to better support engagement with and reporting to the LLAs.

12. Members will note that the budget and MTFS have been based on 32 participating LLA LGPS funds. This is because although all 33 funds have now become participating members, LB Richmond and LB Wandsworth are in the process of merging their two funds into one combined fund that will be administered by LB Wandsworth. It is not yet clear at this point what the implications of the merger will be for London CIV, but it may be that income and capital will revert to being available from 32 authorities rather than 33. Thus 32 has been used as the prudent position for budgeting at this point. Legal advice is being sought on the implications of the merger, but for clarity, London CIV has no specific view on the likely or desirable outcome.

13. This budget and MTFS will be taken to the 8 February meeting of the Joint Committee with a view to receiving the necessary shareholder approval.

## **Governance**

14. The governance arrangements for LCIV and the participating LLAs were developed at an early stage and in the context of LLA participation at all levels being entirely voluntary. The government's intervention in terms of requiring all LGPS funds to pool has changed the environment to a more mandatory position. With that in mind, and because LCIV has completed its first year of operating it is proposed to commission a governance review that will cover arrangements both inside and outside the organisation.

15. In broad terms the aim of such a review will be to ensure that the overall governance structure is fit for purpose, and structured to ensure the right levels of control, decision making, and oversight.

16. LCIV's Board is fully committed to the review and has been consulting with the LLA Treasurer reference group to draft the terms of reference and scope which is attached for the consideration and approval of Leaders' Committee. Subject to the views of

Members a search and selection will be undertaken to find a suitable organisation (or suitably qualified individuals) to undertake the work. The aim will be to have a final report ready for consideration ahead of the summer recess.

## **Government LGPS Reform Agenda**

17. From previous briefings Leaders' Committee will be aware that asset pooling is now a requirement imposed by the government on the entire LGPS. This intervention has changed the position for the LLAs from a voluntary collaboration to a much more mandated position and a requirement to deliver on four government imposed criteria:

- i. Asset pools, each with at least £25bn of Scheme assets;
- ii. Strong governance and decision making;
- iii. Reduced costs and excellent value for money; and
- iv. An improved capacity to invest in infrastructure.

18. LCIV ticks all the boxes against the criteria in principle, but the first will be a real challenge that may take several years to achieve – unlike a number of the other forming pools that have taken active decisions to transition assets as and when the pool is ready.

19. Other than a requirement to have pooling structures established by April 2018 the government has not set a detailed timeframe, simply saying that assets should transfer as quickly and efficiently as possible.

20. In July 2016 a final proposal was submitted to government on behalf of all the participating LLAs and LCIV. In response to that proposal the Minister for Local Government (Marcus Jones MP) invited representatives from LCIV and the LLAs to attend a meeting on 12 December 2016. Following the meeting the attached letter was received from the Minister to which the attached reply was sent. Members will see that the Minister has approved the LCIV arrangements, but with a caveat that he would like to see faster progress in transitioning assets.

## **Recommendations**

21. Leaders' Committee is recommended to:

- i. note the contents of this report;



- ii. reaffirm its on-going support for London CIV and the pooling of London LGPS assets;
- iii. agree to the commissioning of a governance review and agree the attached Terms of Reference and Scope;
- iv. agree to the strategic direction set out in the budget and MTFS; and
- v. make a commitment to work collectively across London authorities to transition assets as swiftly and efficiently as possible.

### **Financial implications**

22. Financial implications are set out in the body of this report and in the attached 2017/18 budget and MTFS.

### **Legal implications**

23. There are no legal implications arising out of this report.

### **Equalities implications**

24. There are no equalities implications.

### **Background Papers**

13 March 2012, Leaders' Committee report:

<http://www.londoncouncils.gov.uk/node/20992>

13 November 2012, Leaders' Committee report:

<http://www.londoncouncils.gov.uk/node/21721>

11 December 2012, Leaders' Committee report:

<http://www.londoncouncils.gov.uk/node/21816>

14 May 2013, Leaders' Committee report:

<http://www.londoncouncils.gov.uk/node/22122>

19 September 2013, Executive report:

<http://www.londoncouncils.gov.uk/node/22314>

26 November 2013, Executive report:

<http://www.londoncouncils.gov.uk/node/22652>

10 December 2013, Leaders' Committee report

<http://www.londoncouncils.gov.uk/node/22666>

11 February 2014, Leaders' Committee report

<http://www.londoncouncils.gov.uk/node/22825>

11 March 2014, Leaders' Committee report

<http://www.londoncouncils.gov.uk/node/22913>

15 July 2014, Leaders' Committee report

<http://www.londoncouncils.gov.uk/node/23092>

14 July 2015, Leaders' Committee report

<http://www.londoncouncils.gov.uk/node/26670>

9 February 2016, Leaders' Committee report

<http://www.londoncouncils.gov.uk/node/28281>



## **2016/17 Budget and Medium Term Financial Strategy**

January 2017



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## Contents

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1.	<i>PURPOSE</i> .....	3
2.	<i>CONTEXT</i> .....	3
3.	EXECUTIVE SUMMARY .....	4
4.	LONDON CIV STRATEGIC FRAMEWORK.....	7
5.	2016/17 BUDGET .....	9
6.	FUND LAUNCH PLANS AND AUM AND REVENUE FORECAST .....	9
7.	EXPENSE FORECAST .....	15
8.	CAPITAL SPENDING FORECAST .....	18
9.	BENEFITS DELIVERY .....	18
10.	FINANCIAL SUMMARY.....	19
11.	REGULATORY CAPITAL REQUIREMENT .....	22
12.	COMMUNICATIONS.....	23
13.	<i>GOVERNANCE</i> .....	23
14.	RISKS TO THE DELIVERY OF THE PLAN .....	25

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## **1. PURPOSE**

This document sets out the following:

- the revised budget forecast for financial year ending March 2017 as agreed by shareholders in December 2016;
- the annual budget as required by the LCIV Shareholder Agreement for the financial year ending March 2018; and
- the Medium Term Financial Strategy (MTFS) covering the annual financial plan for the five years from April 2017 to March 2022.

London CIV's (LCIV) Board has set the strategic direction for the company which is supported by this budget and MTFS. The document has been drafted by the company's Executive team and has been approved by the Board. Day-to-day delivery against the budget is the responsibility of the Executive team which, as with any budgetary process, will require flexibility on managing the detail to ensure that the objectives can be achieved within the overall budgetary framework.

## **2. CONTEXT**

The London CIV journey began back in 2012 with proposals being presented to London Councils' Leaders' Committee that would have led to the complete merger of all of London's 34 Local Government Pension Scheme (LGPS) funds (boroughs, City of London and the London Pension Fund Authority). These proposals were not adopted and instead Leaders' Committee commissioned London Councils officers to facilitate the development of ideas that would deliver most, if not all, of the benefits of merger without the cost, complexity and loss of sovereignty and democratic oversight that would result from merger.

Proposals were developed by a working group comprised of the then London Councils political group leaders and three representative treasurers, which were reported back to Leaders' Committee. In brief those proposals were that:

- A London LGPS Collective Investment Vehicle (CIV) should be set up in the form of an Authorised Contractual Scheme fund (ACS);
- A new company, wholly owned by the participating authorities, should be established to act as operator of the CIV; and
- Participation of the separate London LGPS funds should be entirely voluntary, with responsibility for investment strategy and asset allocation staying at the local level, while responsibility for the appointment and management of external fund managers and the general management, performance and oversight of the ACS fund would rest with the operator.

At the same time that these regional proposals were being developed, discussed and agreed the Government was actively considering the future structure of the LGPS nationally and began to make proposals to bring about complete merger across the scheme into a smaller number of funds. However, the work being done across London was in large part successful

in demonstrating that voluntary collaboration could be delivered and that, as originally aimed for, substantial benefits could be delivered without the need for merger.

In November 2015 the Government published a document ‘LGPS: Investment Reform Criteria and Guidance’ setting out policy for all LGPS funds across England and Wales to develop pools along similar lines to London CIV. The funds were instructed to submit “ambitious proposals” for the establishment of a small number of investment pools based on the requirement that every fund must join with a pool and invest the majority of its assets through that pool over a period of time. This direction from Government effectively changed the environment for London funds and London CIV from being engaged in an entirely voluntary collaboration to a more mandatory position.

It is within this changing regional and national policy framework that London CIV has been established and now operates

### **3. EXECUTIVE SUMMARY**

Since FCA authorisation in October 2015, LCIV has launched 6 sub-funds with £3.1 Bn assets under management (AUM) across 14 boroughs (as of 31 December 2016). LCIV resources have been expanded from three to eleven including recruitment of the LCIV Executive Management team and the organisation has worked with stakeholders to establish an effective partnership which is critical to the success of the organisation. Both the scale of AUM achieved in the first twelve months and the operational progress are a considerable achievement.

During the first year of operation, a number of key lessons have also been identified and it is clear that what LCIV has to deliver as a regulated fund manager, providing excellent client service with potentially £25 Bn of assets under management (AUM) across multiple asset classes, is more challenging than had been envisioned.

The challenges faced by London’s LGPS funds, as for most of the world’s pension funds, are significant and growing. LCIV has to deliver benefits beyond cost savings from scale economies and address the fact that many Pension Fund’s strategic asset allocations will increasingly tilt towards asset classes which require scale and in-house expertise. This will inevitably mean higher up-front costs to ensure LCIV has the requisite skills required to deliver the investments investors will require, but ultimately should result in cash and non-cash benefits of a far greater magnitude than originally envisaged.

A key imperative for LCIV and its investors/shareholder to progress from being a delivery platform for voluntary collaboration of London local authorities (LLAs) to a fully established fund management company able to deliver investor benefits in the widest sense, is to ensure the transfer of assets is completed as quickly as possible as a higher AUM base will:

- lead to faster delivery of greater fee savings;
- allow LCIV to efficiently offer a broader range of investment products; and
- allow LCIV to cover its costs and be less reliant on additional LLA funding.

#### **2016/2017 Budget**

The status of the annual budget for 2016/17 was reviewed and approved by the shareholders at the General Meeting of the Company held on 13th December 2016. The budget forecast £1.5Mn in revenues, £2.3 Mn operating expense and a deficit of near £800K. The shareholders agreed that the 2016/17 deficit would be covered by existing capital reserves, which would be recovered in future years as LCIV moves to profit and balance balanced budget.

### **2017/2021 Forecast and Plans**

During the next phase of LCIV's development in the period 2017-2021 as it moves from set up through implementation to full 'business as usual' (BaU), LCIV's key priorities are to:

- Continue to work closely with the LLAs to respond to their investment needs and ensure the opportunities LCIV identifies across Global Equities, Fixed Income, and other cash flow-generating asset classes such as Real Estate, Infrastructure and other "alternative" asset classes, will meet those needs;
- Expand LCIV's staff complement in the front, middle and back office to bring on board the necessary capacity, knowledge and skills to deliver the different asset classes, volume of planned fund launches, and ensure that the company can fulfil its fiduciary responsibilities;
- Establish scalable, fit for purpose, system and process capabilities for client reporting, performance management reporting, and risk management; and
- Develop clear and transparent communications with LLAs and stakeholders.

**AUM and Revenue Forecast.** The plan includes a broadening of asset classes during 2017-2021 with the launch of Global Equities and Fixed Income funds in 2017/18 and 2018/19, Real Estate in 2018/19 and 2019/20, and Infrastructure and Alternatives in 2019/20. Overall, as a result of this expansion the number of sub-funds is likely to increase from 6 to 28 under current assumptions, leading to a forecast increase in AUM from £3.2 billion in March 2017 to £14.1 billion by March 2022. This is equal to 49% of the £29.2 Bn total LLA assets (as of March 2015). Based on the projected AUM growth and other current assumptions, management fees are forecast to grow from £640K at end 2016/17 to £3.9 Mn by end 2021/22.

As it is difficult for LCIV to accurately forecast AUM growth and resulting management fees as decisions to transition assets reside with the LLAs, a number of revenue and cost scenarios have been modelled (working with a sub-group of LLA Treasurers) before finalising the proposed Annual Budget. With the budgeted AUM growth, LCIVs management fees are unlikely to cover annual operating costs over the planning period and additional funding will be required.

It is important to point out that based on LCIVs estimates approximately 60% of 2017/18 expenditure will be focused on fund launches and development projects, with only 40% being targeted on recurring activities or BaU. This ratio of fund launch/development projects to BaU expenditure is forecast to change gradually over the planning period shifting to 10% fund launch/development projects and 90% BaU spend in 2021/2022.

In order to cover the cash flow imbalance between annual revenues and annual costs, LCIV is proposing to introduce a development funding charge (DFC) until LCIV generates sufficient management fee income to cover annual operating costs. The DFC would be in addition to the annual service charge and will decline year on year starting at £75,000 in 2017/18 and reducing to £10,000 in 2021/22 as AUM and management fees rise over the five years.

On 16 December 2016 Marcus Jones MP (Minister for Local Government) wrote to Lord Kerslake, Chair of LCIV, following a meeting to discuss the joint submission of LCIV and the LLAs to government in July 2016. In his letter the Minister noted that, in the government's view, the current forecasts and transition of assets into the LCIV pool will be "unacceptably slow".

Using a more optimistic AUM growth scenario where £19.4 Bn or 67% of the £29.2 Bn LLA assets are transferred to LCIV by March 2022, the DFC would drop to £25,000 in 2019/20 and LCIV would become self-funded through management fees and the annual service charge in 2020/2021, two years earlier than the current plan.

**Expense Forecast.** Given the expansion in the variety of asset classes and sub-funds, additional resources and systems are required to support:

- the number and variety of funds;
- ongoing investment oversight and risk management; and
- client, financial, and regulatory reporting.

On this basis, total expenses are forecast to increase from £2.3 Mn in 2016/17 to £4.9 Mn in 2019/20 driven by:

- an increase in staffing levels from 11 to 25 over the planning period, which accounts for more than 50% of the cost base;
- investment in client reporting, performance management and risk systems; and
- legal and professional fees associated with sub-fund launches, particularly new asset classes which will require new legal structures and front and back office operating processes to be developed.

**Capital Expenditure.** The forecast includes a total capital expenditure of £150,000 in 2018/19 which is comprised of:

- £100,000 for ICT equipment to improve IT resilience, and functionality, which will be depreciated over 3 years; and
- an allowance of £50,000 for fixtures and fittings to fit out expanded accommodation which will be depreciated over 3 years.

**Enterprise Risks.** LCIV Board and Executives have reviewed the risks associated with delivering the 2017/18 plans and identified the key Enterprise Risks, mitigation plans and key risk indicators as outlined in the Enterprise Risk Register, Fig 11. These risks will be monitored on an ongoing basis and status reported quarterly to the Board and stakeholders.



**Performance Reporting.** LCIV will provide quarterly reports on performance of its funds, annual and half yearly report and accounts and regular newsletter updates. In addition, LCIV's Executive team will provide an update to the Board and stakeholders on progress against the business plan's 2017/18 objectives, including fund launches, financial performance and forecast for the remainder of the financial year and risks.

#### 4. LONDON CIV STRATEGIC FRAMEWORK

LCIV's strategic framework outlines the core purpose of the organisation, its vision, and the value proposition to the LLAs.

**Purpose.** LCIV's purpose is to create a collective investment vehicle for London Local Authority (LLA) Pension Funds which delivers broader investment opportunities and enhanced cost efficiencies than LLAs can achieve individually and overall better risk-adjusted performance.

**Vision.** LCIV aims to be the vehicle of choice for Local Authority Pension Funds through successful collaboration and delivery of compelling performance

**Value Proposition.** The LCIV value proposition to the LLAs focuses on:

- Performance:** providing superior risk adjusted investment outcomes by leveraging scale economies and full-time resources focused purely on investment management
- Opportunity:** providing a broader range of investment opportunities than might be accessible by an LLA acting alone
- Efficiency:** providing cost effective investment products through leveraging the scale of LLA pooled assets and being an efficient organisation
- Transparency:** providing transparent reporting across investment performance, client reporting, risk management and client benefits

**LCIV Objectives.** Below are LCIV's Aims and 2017/18 Objectives and KPIs.

LCIV Aims
<b>Investments and Investment Oversight</b> <ul style="list-style-type: none"> <li>• Deliver cost effective investment solutions which enable the LLA Pension Funds to meet their investment objectives</li> <li>• Demonstrate and deliver effective investment oversight appropriate for a large scale regulated investment vehicle</li> </ul>
<b>Client Service</b> <ul style="list-style-type: none"> <li>• Provide excellent client service</li> <li>• Deliver identified client cost savings benefits</li> <li>• Deliver transparent, regular and effective reporting to clients and stakeholders</li> </ul>
<b>Finance and Business Operations</b> <ul style="list-style-type: none"> <li>• Achieve target AUM levels and revenues</li> <li>• Maximise operational and cost efficiencies</li> <li>• Establish a high-performing learning organisation</li> </ul>
<b>Governance, Risk and Compliance</b> <ul style="list-style-type: none"> <li>• Deliver LCIV's value proposition within an effective governance structure</li> <li>• Remain an enterprise risk managed and compliant company</li> </ul>

## LCIV 2017/18 Objectives

### Investments and Investment Oversight

- Complete launch of identified and agreed commonality funds
- Launch Global Equity and Fixed Income fund strategies as prioritised in collaboration with LLAs and supported by a business case and transparent benefits
- Deliver quarterly investment oversight dashboard monitoring mandate drift and performance and taking proactive action where required

### Client Service

- Complete assessment of LLA needs based on triennial valuation results
- Agree client reporting and service model and implement including SLA
- Establish robust and transparent benefits reporting by LLA

### Finance and Business Operations

- Manage costs in line with approved budget
- Finalise target operating model and complete implementation of core systems
- Deliver staff recruitment plan
- Meet LCIV Board and stakeholder MI and reporting requirements and timetables

### Governance, Risk and Compliance

- Maintain compliance with FCA regulation including third parties
- Unqualified annual audit report
- Satisfactory Depositary reviews (no red/critical issues)
- Maintain Enterprise Risk register and manage business in accordance with risk appetite statement and agreed tolerances

## LCIV 2017/18 KPIs

- AUM: At or above £6.3 Bn
- Income: Management fee income in line with budget
- Expenses: Expense spend in line with budget
- Clients: Deliver products and services from which all 32 LLA pension funds can benefit and have agreed and signed SLAs in place
- Staff: 13 staff on-boarded
- Governance: No significant audit or compliance issues

**Charging Principles.** As LCIV's purpose is to improve cost efficiency and provide better risk adjusted performance and broader investment opportunities for Local Government Pension Scheme Funds, the company does not aim to make a significant profit. In light of this, LCIV has developed the following charging principles and structure.

**Fairness:** Charges should be structured as fair as possible to ensure benefits and costs are fairly distributed across investors.

**Transparency:** LCIV will be transparent with any charges to the LLAs and provide quarterly budget updates to stakeholders.

**Structure:** LCIV's business model currently has two charging mechanisms:

- (i) a management fee on AUM
- (ii) an annual service charge of £25,000

LCIV is still in the build phase of development and will require additional funding to invest in required skills, expertise and core infrastructure in order to become a fully established fund management company. To address this funding need, LCIV is proposing to introduce a development funding charge (DFC) to cover the investment required to build the organisation and become self-funded.

**Management Fee:** The key criteria when setting the LCIV management fee level is to ensure that clear, material net benefits can be achieved inclusive of the LCIV management fee. Therefore, LCIV will ensure:

- Management fees in the annual budget and MTFS will be set at prudent levels
- Management fees are transparently included in the TER of each sub-fund; annual service charge costs are not included in the TER

**Service charge:** The £25,000 annual service charge is akin to a membership fee providing access to the breadth of LCIV services. The charge is invoiced at the start of each financial year.

**Development Funding Charge (DFC):** The DFC will cover the investment needed to build out LCIV's fund offering and organisational infrastructure. The DFC level will be set through the annual planning process and proposed to the shareholders when the Annual Budget for each financial year is set. It is proposed that the DFC is invoiced in two parts with 66% of the charge invoiced in April with the remaining 33% to be invoiced in December of each financial year. The December invoice will be adjusted according to the prevailing budget and business needs.

## 5. 2016/17 BUDGET

The status of the annual budget for 2016/17 was reviewed and approved by LCIV Shareholders at the Company General Meeting held on 13<sup>th</sup> December 2016. The summary figures from the budget include £1.5Mn in revenues, £2.3 Mn operating expense and a deficit of near £800K. The Shareholders agreed that the 2016/17 budget deficit would be covered by existing capital reserves. Details of the 2016/17 budget and capital adequacy statement can be found in Appendix A.

## 6. FUND LAUNCH PLANS AND AUM AND REVENUE FORECAST

**Investment Principles.** LCIV is currently developing a proposal for Investment Principles and will be sharing this with the LLAs to develop a high level set of investment principles which will provide a framework for LCIV's efforts to identify and offer attractive investment opportunities aligned with the LLA's principles and needs.

**Current fund status and revenue.** As of end December 2017, LCIV has launched 6 sub-funds and 14 LLAs are invested with £3.2 Bn AUM. Management fee income in the first half of 2016/17 was £260K and forecast to reach £640K by March 2017. The service charge for the current year is £25K per LLA with total service charge revenue of £850K including a payment from one LLA from 2015/16. Consolidated management fees and service charge revenue for the first year of operation are forecast to be £1.5 Mn.

**Fund launch and AUM forecast.** LCIV will be completing the sub-fund launches of the Commonality, Quality and Conviction (CQC) phase encompassing Equities and Multi-Asset funds in early 2017. The asset class prioritisation of the forward looking fund launch plans has been based on the London LGPS Funds consolidated asset allocation as of March 2015. Given that the asset classes with the largest fund allocations are also (relatively speaking) easier asset classes to access, prioritising fund launches based on the size of existing fund allocation was seen as the optimal route to provide opportunities to as many LLAs as possible in the shortest timeframe. As such LCIV has prioritised the procurement of Global Equities funds to be delivered in 2017, followed by Fixed Income funds and broadening to Real estate, Infrastructure and Alternative assets.

While LCIV builds its in-house capacity particularly in the Real Estate and Infrastructure areas, efforts will also be made to explore options to invest earlier in these asset classes. This will include investigating opportunities to work with other areas of the Local Government Pension Schemes (LGPS).

It is recognised that the current triennial valuation may impact the strategic asset allocation and investment needs of the LLAs. With this in mind, LCIV will liaise closely with the LLAs and the Investment Advisory Committee to ensure that the focus of our fund development and investment opportunities are aligned with their needs.

As we move to broaden the asset classes, LCIV should add value beyond leveraging scale to reduce management fees. With the likely changes in strategic asset allocation, combined with fundamental changes in markets, together with industry upheaval for fund managers, the LLAs, working with LCIV, could move beyond standard products and have products built to their specifications which could have both lower fees and materially better returns. This is most applicable to “alternative” asset classes which are planned for launch at the end of 2018 and during 2019, although structural changes in the Fixed Income markets, particularly in traditional, publicly traded assets, have meant that it may be necessary to look at private market debt as we expand into Fixed Income.

The fund launch and supporting plan is based on the cost structure and operational requirements of a single-manager sub-fund operating under LCIV’s current Financial Conduct Authority (FCA) regulatory approvals which do not include advisory services. The fund plan includes an expansion from 6 to 28 sub-funds over the planning period and growth from £3.2 Bn AUM in March 2017 to £14.1 Bn by March 2022. The fund launch plan for 2016/17 and 2017/21 with estimated AUM at launch date are shown in Fig. 1 below.

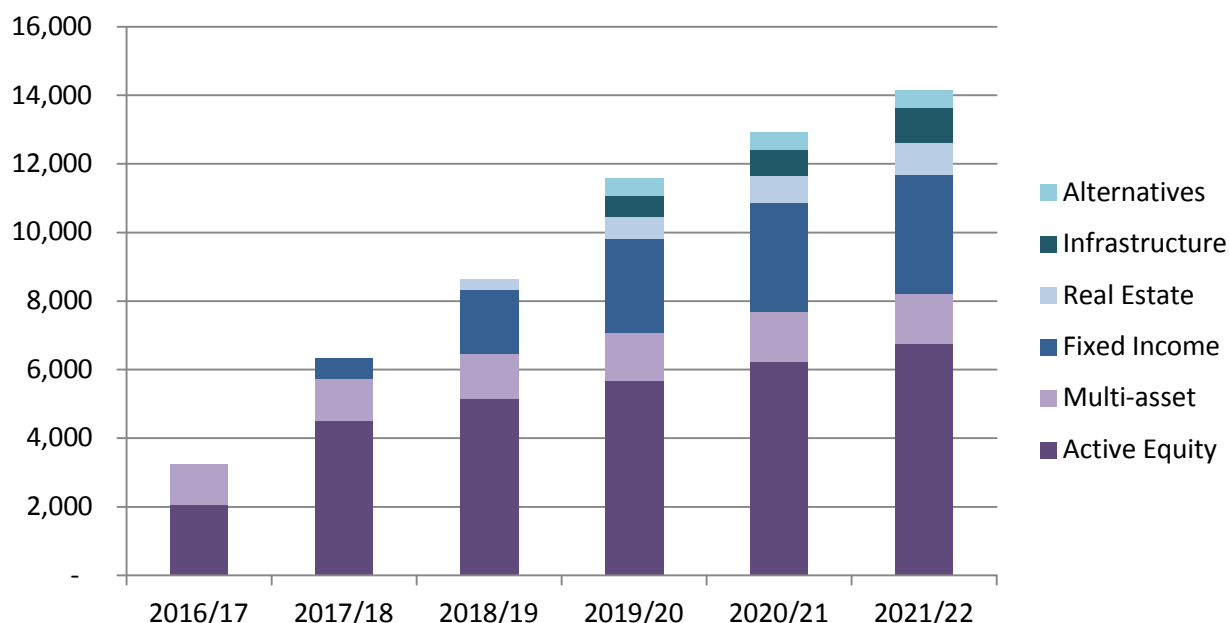
**Figure 1. LCIV Fund Launch Plan with estimated AUM at launch**

	Q1			Q2			Q3			Q4			New Funds	Total Funds
	April	May	June	July	August	September	October	November	December	January	February	March		
2016/17			Ruffer Abs Ballie Gifford Return (£335) Global Alpha (Purford Abs) (£1455) Return (£200)	Work on passive asset structure and fee negotiations					Newton Real Return (£330)				4	6
2017/18	Majedie (£530) Newton Global Equity (£500)	Longview (£450)				Global Equity 1 (£200) Global Equity 2 (£200) Global Equity 3 (£150)			Global Equity 4 (£150) Global Equity 5 (£150)			Fixed Income 1 (£300) Fixed Income 2 (£300)	10	16
2018/19			Real Estate 1 (£300)	Fixed Income 3 (£300) Fixed Income 4 (£300)			Fixed Income 5 (£300) Fixed Income 6 (£300)						5	21
2019/20			Real Estate 2 (£300)	Infrastructure 1 (£300) Infrastructure 2 (£300)			Fixed Income 7 (£300) Fixed Income 8 (£300)			Alternatives 1 (£250) Alternatives 2 (£250)			7	28
2020/21 2021/22	No individual fund launches detailed in plan AuM growth driven by subscriptions to funds on platform													

The fund launch plan for financial years 2020/21 and 2021/22 does not identify specific fund launches either by asset class or size as this is highly speculative given potential asset allocation changes from the next triennial review in 2019. The forecast AUM growth in the plan beyond the initial fund launch AUM is driven by estimates of additional subscriptions into existing funds across the asset classes. The AUM forecast across asset classes is shown in Fig. 2.

**Figure 2. AUM Forecast based on 2017-2021 Fund Launch Plan**

Total AUM (£Mn)



Overall, the forecast AUM of £14.1 billion by March 2022 represents the transfer of 49% of the total £29.2 Bn (as of March 2015) of LLA assets. The forecasted share of LLA asset transfer to LCIV is based on March 2015 LLA asset allocation and outlined below in Fig. 3.

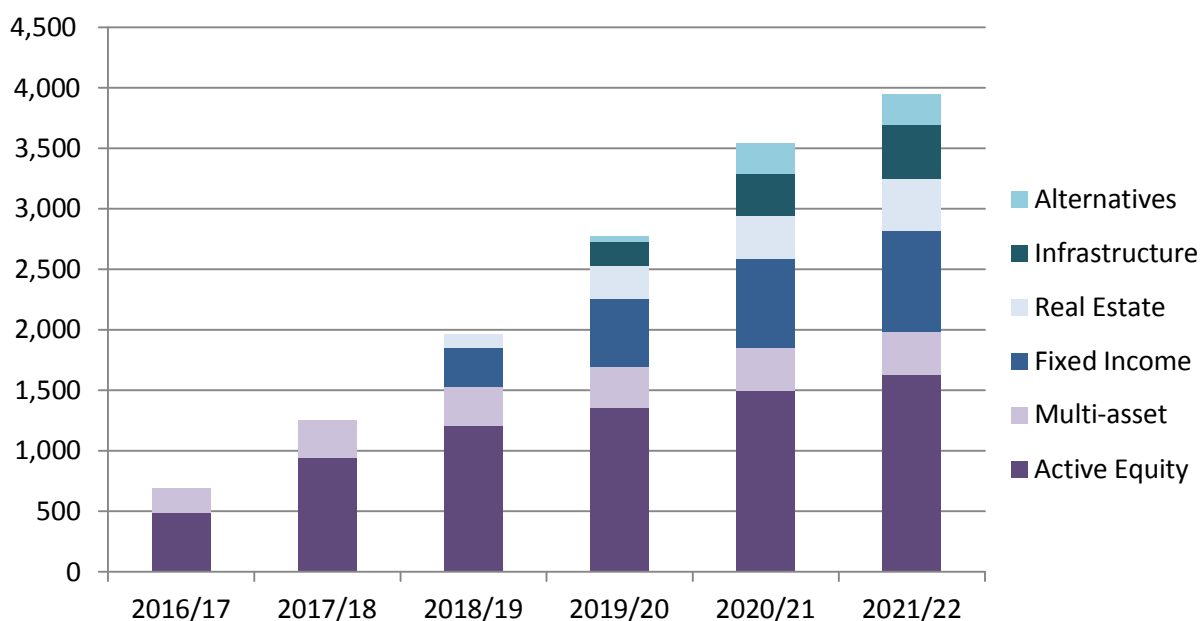
**Figure 3. Share of LLA Assets transferred based on 2017 /21 Fund Launch Plan**

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Share of LLA Assets	Mar-17	Mar-18	Mar-19	Mar-20	March 21	March 22
Active Equities	21%	46%	53%	59%	64%	70%
Passive Equities	0%	0%	0%	0%	0%	0%
Multi Asset	45%	48%	50%	52%	55%	55%
Fixed Income	0%	12%	38%	55%	64%	70%
Property	0%	0%	14%	32%	38%	45%
Infrastructure	0%	0%	0%	306%	398%	517%
Alternative Assets	0%	0%	0%	36%	36%	36%
Total share of LLA Assets transferred	11%	22%	30%	40%	44%	49%

**Revenue forecast.** Based on the fund launch plans and estimated AUM, the management fee revenue is forecast to grow from £640K at end 2016/17 to £3.9 Mn by end March 2022. LCIV is also currently working with stakeholders to agree an approach to passive assets. During 2016/17, LCIV negotiated significant savings for fourteen funds invested with Legal & General and it has been suggested that the LLAs who benefitted from LCIVs time and effort should pay a fee for the realised benefits. This potential fee would be additional income and has not been included in the revenue forecast. The management fee forecast for the planning period is shown in Fig. 4 below.

**Figure 4. Management fee Revenue Forecast**

Total Management Fee (£000)



The assumptions of the above revenue forecast over the planning period include:

- management fees per asset class are constant over planning period
- management fee for Equities and Fixed Income is 2.5 basis points (bp)
- management fee for Real Estate, Infrastructure and Alternatives is 5.0 bp
- additional subscriptions are made to funds where no capacity constraints apply
- passive funds will be managed outside LCIV and no passive fee revenue is included
- there are no fund redemptions or sub-fund closures during the planning period
- current LCIV regulatory approvals are sufficient to implement plans

There are two key components for LCIV to deliver the above fund launch plans and associated revenue targets. These include:

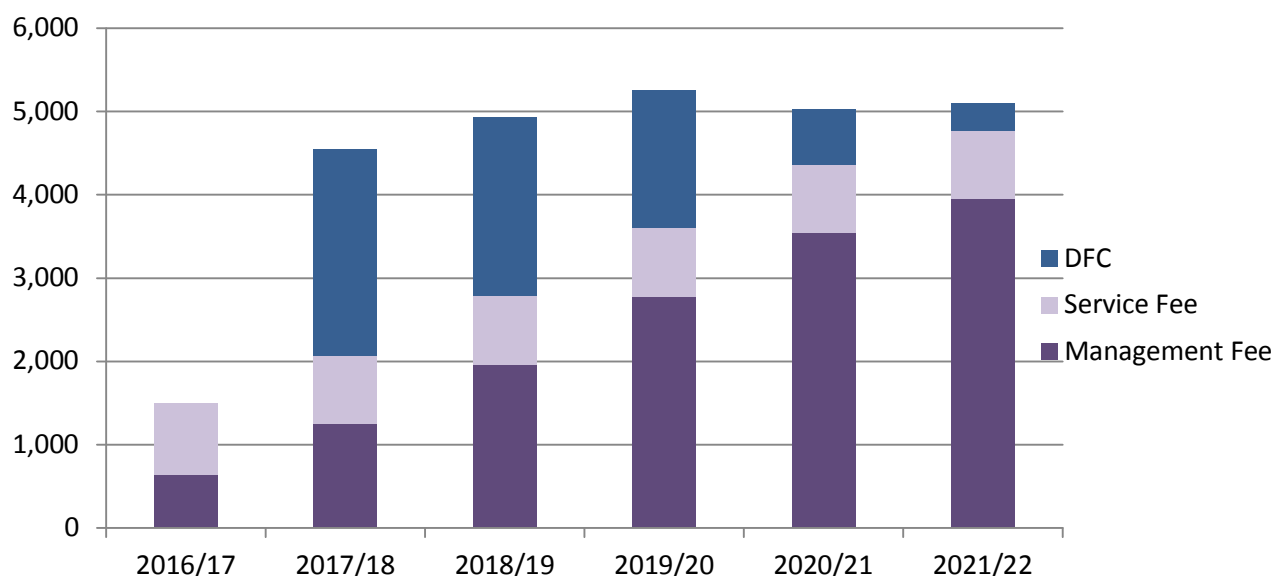
- the provision of attractive investment opportunities by LCIV to the LLAs
- the pace at which the LLAs transfer their assets to LCIV

**Service Charge and Development Funding Charge.** The annual service charge for the planning period will be at £25,000. The DFC which is proposed to be introduced in 2017/18 would be set at £75,000 in 2017/18 and decline year on year to £10,000 in 2021/22.

**Total revenue forecast.** Based on the management fee forecast, service charge and proposed DFC, the total revenue is forecast to grow from £1.5 Mn in 2016/17 to £5.1 Mn in 2021/22 enabling the company to invest in the critical resources, skills and infrastructure to deliver the forward looking plans. Total revenue forecast is shown in Fig. 5.

**Figure 5. Total Revenue Forecast**

Total Revenue (£000)



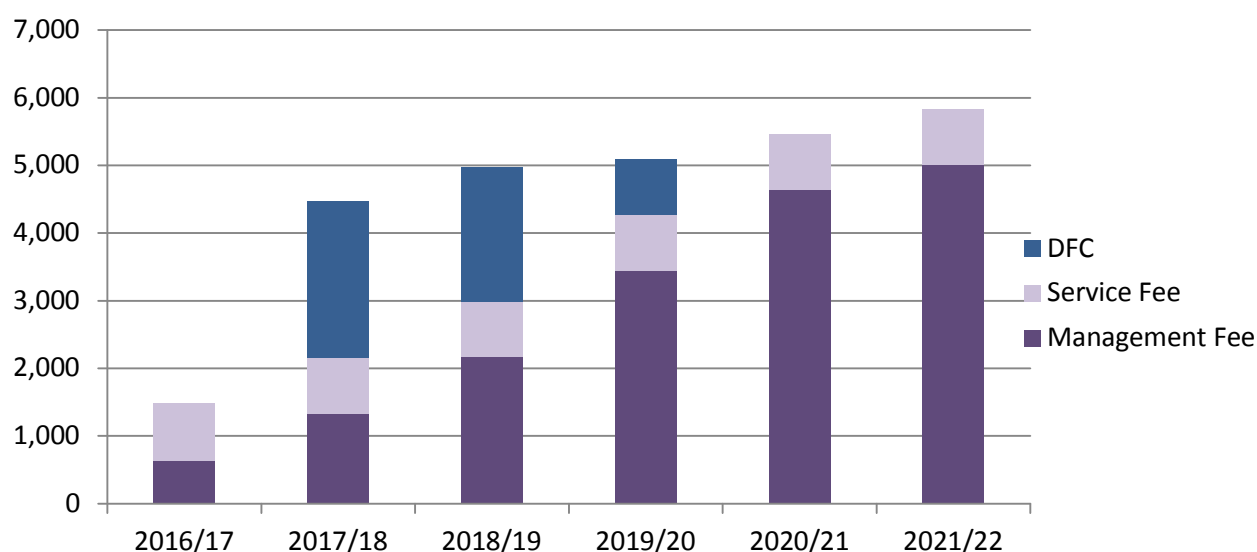
On 16 December 2016 Marcus Jones MP (Minister for Local Government) wrote to Lord Kerslake (Chair of LCIV) following a meeting to discuss the joint submission of LCIV and the LLAs to government in July 2016. In his letter the Minister noted that, in the government's view, the current forecasts and transition of assets into the LCIV pool will be "unacceptably slow".

Recognising that transition of assets can only happen as and when LCIV provides the necessary investment opportunities and material benefits can be accessed, a more ambitious pace of fund transfer would suggest that AUM of £19.4 Bn could be achieved by March 2022 (versus planned £14.2 Bn) representing 67% of total LLA assets (versus planned 49%). Apart from responding to the government's challenge this would also result in the DFC declining to £25,000 in 2019/20 and enabling LCIV to cover its annual operating costs from fund management fees by 2020/21, two years earlier than forecast in the current plan. This scenario is based on a faster pace of asset transition and assumes no change in the forecast cost, cost structure or number of funds. LCIV will work closely with the LLAs and seek to jointly deliver a more aggressive pace of asset transfer during the planning period. A summary of revenue scenario with increased pace of fund transfer is shown below in Fig.6.



**Figure 6. Revenue Scenario**

Total Revenue (£000)



## 7. EXPENSE FORECAST

LCIV is moving from implementation and proof of concept to a key development phase for the organisation which requires additional resource investment to deliver proposed fund launch plans. The key cost drivers over the planning period are the variety, complexity and number of sub-funds, staff expansion, investment procurement, professional costs relating to fund structuring and launches, and core information and communication technology (ICT), risk and systems implementation.

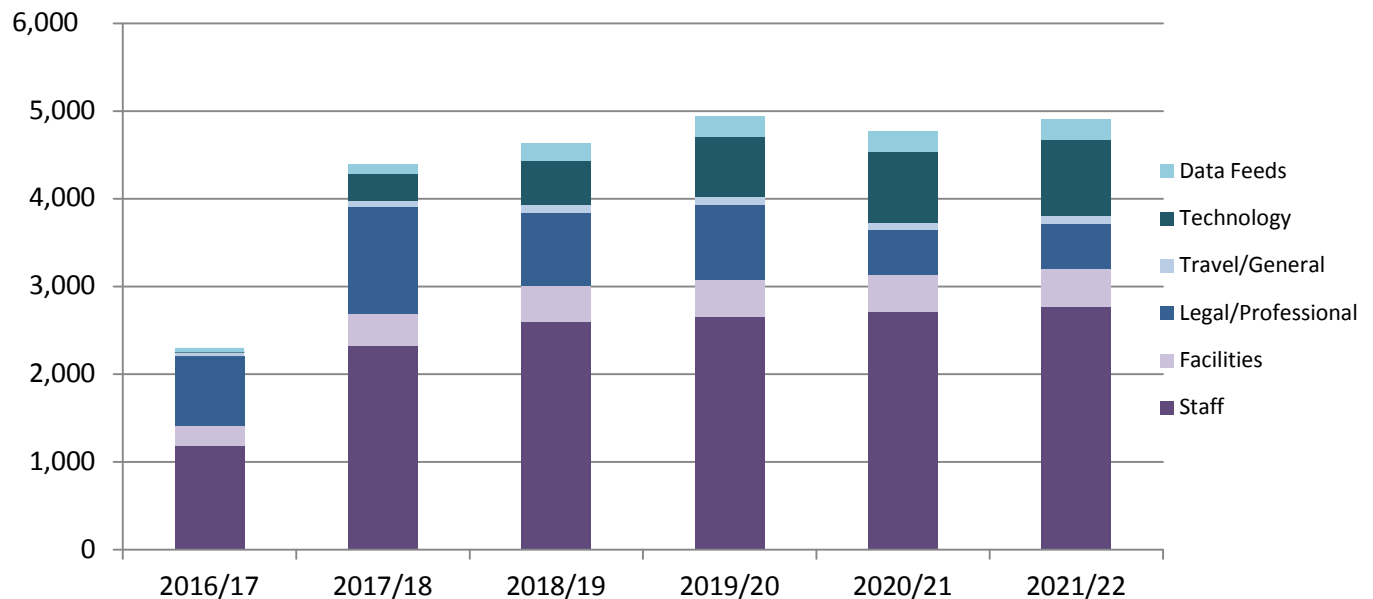
From the current base of 6 funds, the number of funds is forecast to increase to 28 and new asset classes may require different fund structures outside of LCIV's Authorised Contractual Scheme (ACS). Staffing to support the growth in assets and business complexity is planned to increase from 11 to 25 resources. There will be a continuing need to utilise external legal and professional services for the fund launches, technology development and organisational expansion.

Consequently, LCIV's costs will increase from £2.3 Mn in March 2017 to £4.9 Mn by March 2022. The increase in costs is primarily driven by operating costs (including the need to recruit staff with the appropriate skills and knowledge base), as well as costs relating to fund launches and operational set up.

To be consistent with the charging principles and ensure costs are fairly distributed across stakeholders, LCIV will be proposing charging fund opening costs such as legal fees and investment consulting fees to the funds, where possible. Accordingly, investors in the fund would incur the directly related fund set-up costs. These costs could be in the region of £50K per sub fund, but can be amortised over a number of years to reduce the immediate impact on early investors. However, for cash flow reasons, the financial plan includes the budgeted set up costs as an LCIV expense currently and would reduce LCIV costs if charged to the sub fund. A summary of the expense forecast is shown below in Fig. 7

**Figure 7. Total Expense Forecast**

Expense Total (£000)



The rationale and key assumptions across the cost line items are outlined below:

**Staff.** The staff expansion plans and timing have been driven by three key factors:

- fund launches by asset class (see Fig. 1) and the need to hire front office investment, investment oversight and client support capabilities to deliver and monitor a the planned fund range;
- the need to hire core skills for middle and back office including a fund accounting, risk management, and systems and data management; and
- additional middle and back office staff to support the compliance and operational requirements of the fund expansion.

An overview of the current resources and staff build plans are in Fig. 8 below.

**Figure 8. 2017/18 Staff Build Plans**

Year	Quarter	Front Office	Middle/Back Office	New Staff	Total Staff
<i>CEO and Office Manager/EA</i>					
<i>Current Resources</i>		<i>CIO</i> <i>AD Borough Client Management</i> <i>Head of Investment Oversight</i> <i>Investment Analyst</i> <i>Investment Analyst</i>	<i>COO</i> <i>Programme Director</i> <i>Compliance/Risk Manager</i> <i>Operations Manager</i>		11
2017/18	Q1	Global Equities Manager AD Investment Oversight/ Performance Client management Assistant	Fund Accountant Systems/Data Manager	5	16
2017/18	Q2	Fixed Income/ Alternatives Manager	Management Accountant Operations Assistant Project Manager	4	20
2017/18	Q3	Real Estate/ Infrastructure Manager	Risk Officer	2	22
2017/18	Q4	Client Management Assistant  Administrative Assistant ---- General Support		2	24
2018/19	Q1		Compliance Assistant	1	25

The plan envisages front office staff growing from 5 to 11 staff. The hiring plan has been developed to ensure:

- adequate time for asset class managers to be in place prior to the launch of the new asset class funds;
- sufficient client management resources to deliver effective LLA engagement, service and appropriate data and reporting to the LLAs; and
- robust oversight of sub-funds, including rigorous challenge of investment manager performance.

In order to ensure the business is properly supported, compliant with regulatory requirements, and that risks are adequately identified and managed, the resourcing plan includes the middle and back office growing from 4 to 11 staff. The new staff will fill key functional areas including:

- 
- fund and firm accounting
  - risk management
  - systems and data support
  - compliance
  - operations.

A general administration assistant will be hired to support the administration needs of both the front and back office staff and expansion.

The remuneration of staff has been budgeted using scales and salary bands of London Councils as a guide. In addition, the LCIV Board is committed to following the London Council Diversity and Equality Guidelines and will apply these during the LCIV staff recruitment process.

**Legal and Professional Fees.** LCIV work with a variety of professional advisers who advise and assist on a number of technical issues over the planning period. Eversheds are the main source of legal support and provide advice on fund launches, tax, Freedom of Information (Fol), regulatory compliance, employment and governance matters. Other professional service costs include investment oversight support, audit services with Deloitte, Financial Conduct Authority (FCA) fees, internal audit costs, and investment consultant fees in respect of new fund launches and procurement. There will also be consulting support for IT implementation and staff expansion and hiring.

**Technology and Data Feeds.** ICT support is currently provided by London Councils/City of London as part of the facility arrangements with London Council. As the business requirements of LCIV grow, the technology infrastructure will require additional resources both in terms of staffing and systems to ensure that the appropriate level of resilience and disaster recovery/business continuity support are in place and appropriate to the scale and size of a substantial asset manager. The target operating model will be scoped in Q1 FY 2017 for the systems infrastructure across client and management reporting, performance measurement, online client portals, business continuity and risk management.

As the range and complexity of the ACS platform grows and its fiduciary responsibilities increases, LCIV must ensure that the staff and the Board have the necessary tools to manage this growth and deliver appropriate oversight of the operation. Investment in the infrastructure will allow for operational leverage as the AUM and business expands.

## **8. CAPITAL SPENDING FORECAST**

The forecast includes a total capital expenditure of £150K in 2018/2019, comprising £100,000 for ICT equipment which will be depreciated over 3 years and an allowance of £50,000 for fixtures and fittings to support office expansion within London Councils' Southwark Street offices which will also be depreciated over 3 years.

## **9. BENEFITS DELIVERY**

LCIV is focused on delivering benefits to the LLAs. Regarding quantifiable benefits for the initial launch phase of funds, these have been calculated based on the fee scales pre and

post transition and include the costs associated with the LCIV charges including asset servicer and custody costs.

As of end Q3 2016, the total benefits delivered on £2.5 Bn AUM was estimated to be just under £1m annualised. Incorporating the second half 2016/17 fund launch plan and AUM forecast, the estimated benefits delivered in 2016/17 is forecast to be £1.5 Mn annualised on £3.2 Bn AUM. An additional three sub-funds are forecasted to be launched during Q2 of 2017 with a further £1.5 Bn AUM delivering an estimated £2.4Mn annualised additional savings. In addition, LCIV have negotiated significant savings fee savings for fourteen LLAs invested with Legal & General in passive life funds delivering an annualised savings of £1.85m net on the £3.1 Bn AUM held in LGIM passive life funds outside of LCIV.

With the completion of the CQC in the early FY 2017, the approach to calculating benefits will be reviewed. Where new funds are being launched through a procurement exercise, estimated savings will be provided by comparing the standard institutional rates charged by third party investment manager fees compared to the rates being offered through LCIV.

Tax benefits, procurement savings and lower custody costs are additional cashable benefits with the first procurement benefits being realised with global equity exercise that is currently underway. It is not possible to estimate withholding tax benefits with any accuracy at this point without undertaking a complex and time consuming exercise, however the ACS is a more tax efficient fund structure than many others and was the determining factor in choosing this fund model. Custody costs will be reduced as assets increase through the CIV, but also at a local level, where LLA custody costs should decrease over time as assets are moved across to LCIV.

The non-cashable or softer benefits previously outlined include: data transparency and data access, shared investment manager oversight, regulatory scrutiny, governance, access to alternative investments, responding proactively to the wider LGPS efficiency agenda, market management as well as greater levels of responsible investment and engagement across London.

## **10. FINANCIAL SUMMARY**

The key summary financials over the planning period show AUM growth from £3.2 Bn to £14.1 Bn and an increase in related management fee income from £640K to £3.9 Mn. Increased spend on critical staff and systems resources to build out the core investment and operational processes and procedures will result in costs increasing from £2.3 Mn to £4.9 Mn. As previously noted, the increase in costs is due to fund launches, operational set up and normal operating costs with the earlier years of the plan's costs relating to fund launch and set up.

To fund the shortfall during this key development phase, LCIV is proposing a DFC of £75,000 in 2017/18. The DFC will be invoiced in two parts; two thirds of the DFC will be billed in April at the beginning of the financial year and the balance invoiced in December in the financial year to which the DFC relates. The DFC will be set and agreed as part of the annual budgetary process which according to the shareholders' agreement will be agreed no later than 60 days prior to the beginning of the relevant financial period. The DFC will decline over the planning period as management fee income increases and LCIV becomes self-funding from management fee income.

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The service charge is forecast to remain constant at £25,000 and will be invoiced annually in April at the beginning of each financial year.

The majority of LCIV's expenses are either monthly (payroll, reporting partner, IT costs, data feeds) or quarterly in arrears such as London Council's (facilities) or City of London's fees. Consulting and other professional fees which are fund or project related are ad hoc in nature but represent less than 15% of annual expenditure.

LCIV is not a capital intensive operation and over the course of the five years of the MTFS, has budgeted for capital expenditure of a total of £150K to cover IT upgrades and office refurbishment in financial years 2017/18. The capital expenditure is required to cover office expansion due to the increase in headcount and increased IT infrastructure resilience. Therefore, the balance sheet of LCIV is operationally liquid and meets the requirement for FCA capital adequacy purposes and LCIV does not anticipate cash flow management challenges provided the annual service charge and DFC are paid as invoiced.

If any significant surplus occurs during the planning period, LCIV's Board will propose one of three options to the LLAs, those being:

- (i) retain surplus and increase capital within the business,
- (ii) reduce DFC, annual service charge and/or ad valorem charge in subsequent years
- (iii) pay out surplus to shareholders as a dividend

The 2017/2021 Profit and Loss, Balance Sheet and Cash Flow summary statements are shown the Summary Financial Statements below in Fig. 9.

**Figure 9. Summary Financial Statements**

KEY SUMMARY DATA	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
	March 17	March 18	March 19	March 20	March 21	March 22
Assets under management (AUM) in £Mn	3,252	6,344	8,641	11,562	12,922	14,129
New Sub-funds launched in year	4	10	5	7	0	0
Total Sub Funds FY Year End	6	16	21	28	28	28
LCIV Staff (FY Year End)	11	24	25	25	25	25
LCIV Shareholders/Investors	32	32	32	32	32	32
Annual Service Charge	25,000	25,000	25,000	25,000	25,000	25,000
Development Funding Charge (DFC)		75,000	65,000	50,000	20,000	10,000

2027/2021 PROFIT AND LOSS	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
	March 17	March 18	March 19	March 20	March 21	March 22
<b>Operating Income</b>						
Service Charge	850,000	800,000	800,000	800,000	800,000	800,000
Development Funding Charge (DFC)		2,400,000	2,080,000	1,600,000	640,000	320,000
Management Fee by Asset Class						
<i>Active Equity</i>	426,990	944,306	1,206,540	1,355,253	1,490,778	1,624,238
<i>Passive Equity</i>	0	0	0	0	0	0
<i>Multi-Asset</i>	212,593	306,270	321,584	337,663	354,546	363,193
<i>Fixed Income</i>	0	0	320,000	562,375	736,106	826,836
<i>Alternatives</i>	0	0	112,500	519,167	958,000	1,134,100
Total Management Fee by Asset Class	639,583	1,250,576	1,960,623	2,774,457	3,539,430	3,948,367
Total Operating Income	1,489,583	4,450,576	4,840,623	5,174,457	4,979,430	5,068,367
<b>Expenses</b>						
Staff	1,185,744	2,318,220	2,596,558	2,657,295	2,710,441	2,764,650
Facilities	231,651	359,256	409,082	419,560	427,751	436,106
Legal and Professional	791,046	1,231,000	836,000	859,000	504,000	519,000
Travel and General Expenses	38,465	67,375	82,750	89,000	89,250	89,240
Technology	6,944	308,458	510,167	682,240	803,500	869,500
Data feeds	43,880	110,000	195,000	230,000	230,000	230,000
Total Operating Expenses	2,297,731	4,394,309	4,629,557	4,937,095	4,764,942	4,908,496
<b>EBITDA</b>	-808,148	56,267	211,066	237,362	214,488	159,871
Depreciation	1,333	1,842	51,719	50,509	50,000	0
Interest Income	15,000	15,000	15,000	15,000	15,000	15,000
<b>PBT</b>	-794,482	69,425	174,347	201,853	179,488	174,871
Corporate Tax @15%	0	0	0	0	0	825
<b>Net Profit/Loss</b>	-794,482	69,425	174,347	201,853	179,488	174,046
	-794,482	-725,056	-550,710	-348,856	-169,368	0

Figure 9. Summary Financial Statements (continued)

2017/2021 BALANCESHEET	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
BALANCE SHEET	March 17	March 18	March 19	March 20	March 21	March 22
<b>Non-Current Assets</b>						
Plant, Property and Equipment (PPE)	5525	5525	155,525	155,525	155,525	155,525
Accumulated Depreciation	1,456	3,297	55,017	105,525	155,525	155,525
Total Non-Current Assets	4,070	2,228	100,509	50,000	0	0
<b>Current Assets</b>						
Cash	4,068,591	4,139,858	4,215,924	4,468,286	4,697,774	4,871,819
Total Current Assets	4,068,591	4,139,858	4,215,924	4,468,286	4,697,774	4,871,819
Total Assets	4,072,660	4,142,086	4,316,432	4,518,286	4,697,774	4,871,819
<b>Capital and Reserves</b>						
A Class Shares	32	32	32	32	32	32
B Class Shares	4,800,000	4,800,000	4,800,000	4,800,000	4,800,000	4,800,000
Retained Earnings	67,110	-727,372	-657,946	-483,600	-281,746	-102,258
Profit/Loss in year	-794,482	69,425	174,347	201,853	179,488	174,046
Total Capital and Reserves	4,072,660	4,142,086	4,316,432	4,518,286	4,697,774	4,871,819
Total Liability and Shareholder Capital	4,072,660	4,142,086	4,316,432	4,518,286	4,697,774	4,871,819

2017/2021 CASHFLOW	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
	March 17	March 18	March 19	March 20	March 21	March 22
<b>Operating Activities</b>						
Operating Profit/Loss	-794,482	69,425	174,347	201,853	179,488	174,046
Depreciation	1,333	1,842	51,719	50,509	50,000	0
Change in Working Capital	0	0	-150,000	0	0	0
Cash from operating activities	-793,148	71,267	76,066	252,362	229,488	174,046
Total change in cash	-793,148	71,267	76,066	252,362	229,488	174,046
Beginning cash balance	4,865,809	4,068,591	4,139,858	4,215,924	4,468,286	4,697,774
Ending cash balance	4,068,591	4,139,858	4,215,924	4,468,286	4,697,774	4,871,819

## 11. REGULATORY CAPITAL REQUIREMENT

The regulatory capital requirement is determined by a FCA formula derived from a combination of AUM and the expenses of the business. As a regulated entity, LCIV is required to maintain a minimum of regulatory capital at all times and must formally report this to the FCA on a quarterly basis.

LCIV was capitalised to cover a budgeted AUM of £25 Bn with the issuance of £4,950,000 of B shares at £1 each. The capitalisation changed during the 2016/17 financial year due the planned merger of Richmond and Wandsworth Pension Funds resulting in a current capitalisation is £4,800,000. LCIV will be able to meet its regulatory requirements based on the current capital position and the proposed financial plan. A summary of the capital adequacy requirements and surplus are below in Fig. 10.



**Figure 10. 2017/21 Capital Requirement**

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
CAPITAL ADEQUACY	March 17	March 18	March 19	March 20	March 21	March 22
AUM Assumptions 2017/2021 (£ Mn)	3,252	6,344	8,641	11,562	12,922	14,129
A = Initial Capital - Euro 125k	111,607	111,607	111,607	111,607	111,607	111,607
B = 0.02% of AUM in Excess of EUR 250 Mn	605,797	1,224,239	1,683,472	2,267,707	2,539,696	2,781,126
C = Quarter of Operating Expenses	574,433	1,098,577	1,157,389	1,234,274	1,191,236	1,227,124
D = Professional Negligence	25,000	25,000	25,000	25,000	25,000	25,000
Regulatory Capital Requirement <sup>1</sup>	742,404	1,360,846	1,820,079	2,404,314	2,676,303	2,917,733
Share Capital	4,800,032	4,800,032	4,800,032	4,800,032	4,800,032	4,800,032
Retained Earnings	67,110	-727,372	-657,946	-483,600	-281,746	-102,258
Current Year P&L	-794,482	69,425	174,347	201,853	179,488	174,046
Total Reserves Carried Forward	4,072,660	4,142,086	4,316,432	4,518,286	4,697,774	4,871,819
Surplus/Deficit Regulatory Capital	3,330,256	2,781,239	2,496,353	2,113,972	2,021,471	1,954,086

## 12. COMMUNICATIONS

The London CIV objective in communicating to stakeholders is to provide transparent and effective communications and to seek ways to deliver ongoing improvements in our communications and reporting processes. LCIV has a wide range of stakeholders with whom it undertakes communications including (but not limited to):

- London local authorities as investors and shareholders
- Wider local government universe
- Central Government
- Investment Managers
- Third Party suppliers
- Media

In particular, the focus with investors and shareholders is to have a regular and consistent communication program to support partnership and two-way dialogue.

LCIV will use a diverse range of channels to communicate with stakeholders including electronic, paper based, verbal, seminars, and surveys. LCIV is committed to providing high quality reporting to its investors, with quarterly reports on performance of its funds, annual and half yearly report and accounts and regular newsletter updates. LCIV will set out its communications strategy and consult with key stakeholders on its content and timing.

## 13. GOVERNANCE

LCIV governance structure includes the Board and a number of committees of the Board, and stakeholder committees including the London Councils' Pensions CIV Sectoral Joint Committee and the Society of London Treasurers led Investment Advisory Committee. These bodies are responsible for providing:

- 
- i. Oversight and scrutiny of LCIV;
  - ii. Providing input, assistance and advice to the development of LCIV's investment product.

A summary of the current governance bodies and their responsibilities are outlined below.

It should be noted that LCIV has engaged with key stakeholders and will be commissioning a governance review to ensure that the governance structures which were set up at the formation of LCIV pool arrangements remain fit for purpose and provide the appropriate levels of communication, governance, planning and decision making.

### **Regulated Entity Governance**

**LCIV Board of Directors.** The LCIV Board comprises four non-executive directors (one of whom is the Chair) and three executive directors (the CEO, COO and CIO). The Board is responsible for overseeing the company's strategic direction including, setting and monitoring the delivery of the business plan and objectives, managing business risk including investment and operational risk, and approving fund launches and investment manager selection oversight.

The Board has the authority to delegate certain matters to Committees; however, the Board retains ultimate responsibility and supervises the discharge of all delegated matters. The Board meets at least four times a year on a quarterly basis. The Board's activities are governed by both the Articles of Association of the Company and the Shareholders' Agreement.

**Investment Oversight Committee (IOC).** The IOC is a Board Committee with responsibility for overseeing, maintaining and monitoring the investment strategy, performance and investment risk of the sub funds. The IOC does this in accordance with the investment policies approved by the Board and the investment guidelines, as set out in the Prospectus and any supporting documentation including the investment mandates and in compliance with the requirements of the AIFM Directive. Membership of the IOC consists of two Non-Executive Directors, one of which is the Chairman, and the Chief Executive Officer. The committee meets four times a year.

**Compliance, Audit and Risk Committee (CARCO).** The CARCO is a Board Committee and is responsible for overseeing the compliance and risk obligations of the Company in its capacity as a FCA regulated entity and as an Operator of the London LGPS CIV Authorised Contractual Scheme, including regulatory requirements, market practice and compliance with the requirements of the AIFM Directive. Membership consists of two Non-Executives one of which has risk oversight experience who is also the Chair, and the Chief Executive Officer. The CARCO meets four times a year.

**Remuneration Committee (REMCO).** The REMCO is responsible for setting the principles and parameters of the remuneration policy for the company and to make recommendations to the Board. Appointments to the Committee are made by the Board in consultation with the Chair of the London Council's Pensions Sectoral Joint Committee (PSJC). Appointments are for a period of up to three years extendable by no more than two additional three-year periods. Membership of the REMCO consists of two non-executive directors and the Chair

and Vice-chairs of the PSJC. The committee meets at least once a year and otherwise as required.

### **Stakeholder Engagement and Governance**

**London Councils' Pensions CIV Sectoral Joint Committee (PSJC).** The PSJC acts as a representative body for those LLAs that have chosen to take a shareholding in London CIV. It exercises functions of the participating LLAs involving the exercise of sections 1 and 4 of the Localism Act 2011 where that relates to the actions of the participating LLAs as shareholders of the company. It also acts as a forum for the participating authorities to consider and provide guidance on the direction and performance of the CIV and, in particular, to receive and consider reports and information from the ACS Operator, particularly performance information, and to provide comment and guidance in response (in so far as required and permitted by Companies Act 2006 requirements and FCA regulations).

**Investment Advisory Committee (IAC).** The IAC is responsible for supporting elected members of the Pensions Sectoral Joint Committee on the investments of the CIV and to liaise with LCIV in defining the investment needs, reviewing fund managers and shaping the annual investment plan. Members consist of pension fund officers and treasurers on a rotating basis for up to three years. The IAC meets on a quarterly basis.

## **14. RISKS TO THE DELIVERY OF THE PLAN**

A number of key assumptions have been made in respect of the fund launch schedule, value of asset transfer, AUM level and staffing requirements and costs.

The performance to plan will be reported on a quarterly basis to the Board and LLA stakeholders. As part of the quarterly reporting, the Executive team will provide an update on progress against the business plan's objectives for 2017/8, including fund launches, financial performance and forecast for the remainder of the financial year. The LCIV Enterprise Risk Register summarising the risks, mitigation plans and key risk indicators (KRIs) is shown below in Fig. 11.

**Figure 11. LCIV Enterprise Risks**

REF	KEY RISK INDICATORS		
<b>1.0</b>	<b>INVESTMENT AND INVESTMENT OVERSIGHT</b>		
<b>1.1</b>	Investment offerings do not meet LLAs' investment needs; LLAs do not transfer assets	<ul style="list-style-type: none"> <li>Track individual LLA engagement, investment barriers</li> <li>Ensure early LLA engagement in procurement process and identification of seed investors</li> <li>Set clear and agreed investment principles</li> </ul>	<ul style="list-style-type: none"> <li>RAG status of LLA engagement by fund offering</li> <li>Variance on target quarterly / annual AUM</li> </ul>
<b>1.2</b>	Investments do not deliver required performance	<ul style="list-style-type: none"> <li>Complete effective and thorough investment manager due diligence</li> <li>Monitor fund performance and challenge investment managers</li> </ul>	<ul style="list-style-type: none"> <li>Quarterly fund performance reporting</li> <li>Investment managers reviews</li> </ul>
<b>1.3</b>	Fund launches delayed and LLA investments/asset transitions delayed	<ul style="list-style-type: none"> <li>Establish disciplined programme management and tracking of milestones</li> <li>Escalation of issues to Exco which may delay fund launch (eg LLA decisions, benefits business case, 3<sup>rd</sup> party timelines, etc)</li> </ul>	<ul style="list-style-type: none"> <li>Launch project milestone delays</li> <li>Number of items escalated to Exco</li> </ul>
<b>1.4</b>	LCIVs success results in fee reductions by current LLA fund managers and LLAs do not transfer assets	<ul style="list-style-type: none"> <li>Effectively leverage scale to negotiate material fee reductions</li> <li>Close and ongoing engagement with LLAs to ensure strategic alignment with LCIVs purpose</li> </ul>	<ul style="list-style-type: none"> <li>Level and transparency of communications with fund managers</li> </ul>
<b>1.5</b>	Government views pace of LLA asset transfer as unacceptably slow creating a damaging response to LLAs/ LCIV	<ul style="list-style-type: none"> <li>Ensure clear articulation of benefits to be gained by moving to LCIV</li> <li>Continue to build trust and confidence of LLAs in LCIVs capabilities to deliver benefits and performance</li> </ul>	<ul style="list-style-type: none"> <li>RAG status of LLA engagement</li> <li>Variance on target quarterly / annual AUM</li> <li>Clarity of benefits in business case</li> </ul>
<b>2.0</b>	<b>CLIENT SERVICE</b>		
<b>2.1</b>	Failure to deliver defined benefits to the London Local Authorities	<ul style="list-style-type: none"> <li>Establish ongoing and transparent engagement with LLAs during fund development process in order to build business case and identify benefits</li> <li>Establish and agree standard benefits calculation approach with LLAs</li> </ul>	<ul style="list-style-type: none"> <li>Fund business case not clearly articulated</li> <li>Variance on target and actual benefits</li> </ul>
<b>2.2</b>	Failure to deliver effective client service and reporting	<ul style="list-style-type: none"> <li>Establish and implement client service and reporting model</li> <li>Develop and complete SLA and implement with each LLA</li> </ul>	<ul style="list-style-type: none"> <li>SLA breaches</li> <li>Dissatisfied clients</li> </ul>

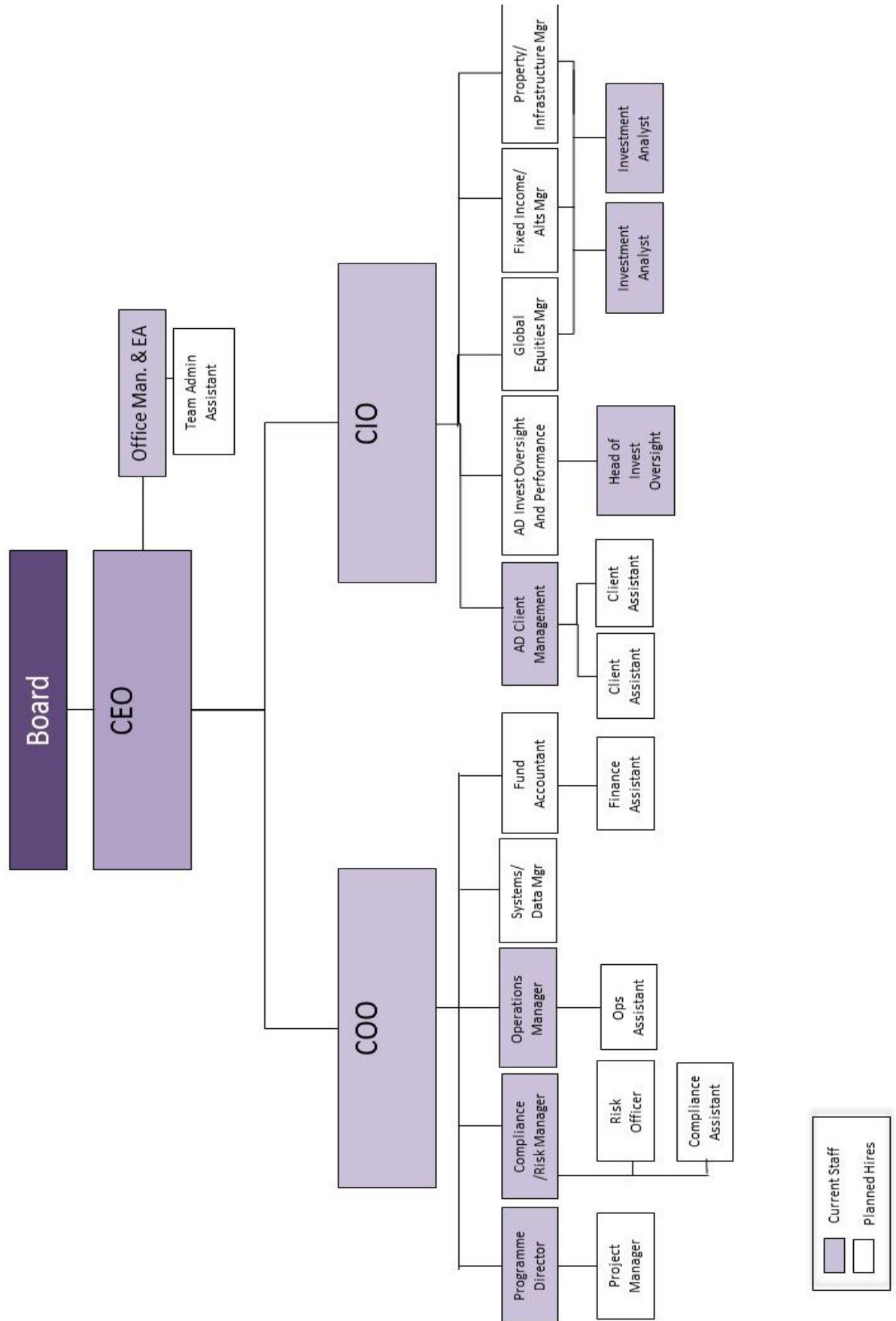
Figure 11. LCIV Enterprise Risks (continued)

REF	RISK	MITIGATION	KEY RISK INDICATORS
<b>3.0</b>	<b>FINANCE AND BUSINESS OPERATIONS</b>		
<b>3.1</b>	Insufficient staff, skills and business processes to deliver against business objectives	<ul style="list-style-type: none"> <li>• Deliver staffing and recruitment plan</li> <li>• Maintain appropriate organisational structure</li> <li>• Ensure staff performance objectives/targets are documented and tracked</li> <li>• Implement target operating model and document business processes</li> </ul>	<ul style="list-style-type: none"> <li>• Hiring plans not in place</li> <li>• Critical skill/functional gaps</li> <li>• Performance targets not met</li> <li>• Effective business processes not in place</li> </ul>
<b>3.2</b>	Financial controls not in place to ensure delivery against budget	<ul style="list-style-type: none"> <li>• Monthly budget reporting to ExCo</li> <li>• Quarterly budget reporting to Board and Stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>• Budget variance in monthly and/or quarterly reporting</li> </ul>
<b>4.0</b>	<b>GOVERNANCE, RISK AND COMPLIANCE</b>		
<b>4.1</b>	Lack of appropriate business governance to deliver against business plan and objectives	<ul style="list-style-type: none"> <li>• Ensure proper governance is followed for decision making</li> <li>• Deliver accurate, timely and comprehensive MI on KPIs and business plan progress</li> </ul>	<ul style="list-style-type: none"> <li>• Inadequate/misleading MI for decision making</li> <li>• Individual decisions made without oversight which impact the budget, business priorities</li> </ul>
<b>4.2</b>	Lack of appropriate culture and tone from the top to establish high performing team and compliant behaviour	<ul style="list-style-type: none"> <li>• Ensure organisation has clear vision and purpose</li> <li>• Establish clear roles/responsibilities, performance objectives and targets</li> <li>• Ensure adherence to LCIV policies and procedures</li> </ul>	<ul style="list-style-type: none"> <li>• Employee engagement</li> <li>• Underperformance (organisational/individual)</li> <li>• Compliance breaches</li> </ul>
<b>4.3</b>	Failure to comply with existing or new financial regulations	<ul style="list-style-type: none"> <li>• Implement thematic based review of controls</li> <li>• Deliver compliance monitoring plan</li> <li>• Complete consistent monitoring and reacting to new regulation</li> </ul>	<ul style="list-style-type: none"> <li>• Items highlighted in compliance monitoring</li> <li>• Volume of new regulation</li> <li>• Items highlighted in external reviews</li> </ul>

**APPENDIX I**  
**2016/2017 BUDGET AND CAPITAL ADEQUACY**

<b>2016/17 SUMMARY BUDGET</b>	
	<b>March 17</b>
<b>Operating Income</b>	
Service Charge	850,000
Development Funding Charge (DFC)	
Management Fee by Asset Class	
<i>Active Equity</i>	426,990
<i>Passive Equity</i>	0
<i>Multi-Asset</i>	212,593
<i>Fixed Income</i>	0
<i>Alternatives</i>	0
Total Management Fee by Asset Class	639,583
Total Operating Income	1,489,583
<b>Expenses</b>	
Staff	1,185,744
Facilities	231,651
Legal and Professional	791,046
Travel and General Expenses	38,465
Technology	6,944
Data feeds	43,880
Total Operating Expenses	2,297,731
<b>EBITDA</b>	<b>-808,148</b>
Depreciation	1,333
Interest Income	15,000
<b>PBT</b>	<b>-794,482</b>
Corporate Tax @15%	0
<b>Net Profit/Loss</b>	<b>-794,482</b>
	<b>-794,482</b>
<b>2016/17 CAPITAL ADEQUACY</b>	
	<b>March 17</b>
AUM Assumptions March (£ Mn)	3,252
A = Initial Capital - Euro 125k	111,607
B = 0.02% of AUM in Excess of EUR 250 Mn	605,797
C = Quarter of Operating Expenses	574,433
D = Professional Negligence	25,000
Regulatory Capital Requirement	742,404
Share Capital	4,800,032
Retained Earnings	67,110
Current Year P&L	<b>-794,482</b>
Total Reserves Carried Forward	4,072,660
Surplus/Deficit Regulatory Capital	3,330,256

## APPENDIX II LCIV ORGANISATION CHART







## **London CIV Governance Review**

### **Terms of Reference and Scope**

#### **Background**

London CIV (LCIV) was launched in December 2015 to be the operator of the London Local Government Pension Scheme (LGPS) pool, bringing together (over time) the pension fund assets of the 32 London boroughs and the City of London Corporation.

Originally the pooling arrangements were being set up on an entirely voluntary basis, with the level of commitment and investment resting entirely with each pension fund. However, in November 2015 the government published criteria and guidance that has changed the environment to one of mandatory pooling. The CIV has also reached full membership of all 33 London LGPS funds and consequently has to review the parts of its governance arrangements that relate to the London Councils' Sectoral Joint Committee that was established to provide democratic oversight of the pooling arrangements and acts as the forum for convening shareholder representatives at General Meetings of the company. It therefore makes sense to undertake a governance review, even though the arrangements have only been in place for a relatively short period of time.

The review is being commissioned by LCIV's Board with full engagement and consultation through London Councils' Leaders' Committee, the Sectoral Joint Committee and with representative borough Treasurers. The final report will be shared with those same groups for review and discussion, and to inform decisions about what changes to the current arrangements may be required.

#### **Purpose**

Consider the governance structures associated with the Pooling arrangements for the London LGPS funds as currently undertaken through LCIV arrangements, recommending potential improvements to ensure that all stakeholders have the necessary and appropriate level of engagement and influence, and that decision making is correctly positioned and defined. This should take into account the fiduciary, regulatory and statutory responsibilities of LCIV, its directors and officers, and the investing LGPS funds, including the impact of MiFID II on the investment status of local government.

Any proposals for change should recognise the stage of development that LCIV has reached (passing through start-up phase and heading towards business as usual) and should ensure that existing and any proposed structures are future proof and represent the most economic, efficient and effective use of scarce public sector resources.

Reference should also be had to the emerging structures in other LGPS pools with a view to determining whether there are any points of best practice that could be incorporated into any amended structure

#### **Scope**

1. Review roles and responsibilities and comment on the overall governance structure of LCIV in the context of its purpose, the requirements and needs of the investing LGPS funds, the government's policy on the pooling of LGPS funds, and the regulatory regime imposed by the FCA.

2. Review and comment on LCIV's committee structures, roles and responsibilities, terms of reference and composition (including the requisite skills, knowledge and training programmes) for the:
  - Board;
  - Executive Committee;
  - Investment Oversight Committee;
  - Compliance, Audit & Risk Committee; and
  - Remuneration Committee.to include documentation of key decisions.
3. Review, roles and responsibilities and comment on the committee structures that sit outside of LCIV, including terms of reference and composition (including the requisite skills, knowledge and training programmes) for the:
  - London Councils' Pensions CIV Sectoral Joint Committee;
  - Investment Advisory Committee
4. Review roles and responsibilities, as defined by regulations, of:
  - London local authority pension Committees
  - London local authority Treasurers
  - London local authority Pension Boards

## **Stakeholders**

Key stakeholders and groups of stakeholders are:

- London CIV directors and staff
- London Councils' Pensions CIV Sectoral Joint Committee
- London local authority Treasurers (AKA Section 151 Officers or the Society of London Treasurers)
- London local authority Pension Committees (or equivalent)
- London local authority Pension Boards
- London local authority Pension Fund Managers (or equivalent)
- Central government (i.e. DCLG and HM Treasury)
- The Financial Conduct Authority

## **Reference Material**

Key reference material includes:

- DCLG, November 2015; Local government pension scheme: investment reform criteria and guidance
- DCLG, November 2015; Design of the structure and governance of efficient and effective collective investment vehicles for LGPS Funds
- CIPFA, Investment Pooling Governance Principles
- LGPS regulations
- Financial Services regulations and the FCA handbook
- Shareholders Agreement
- Articles of Association
- LCIV Business Plan 2017-20
- Relevant LCIV policies, including those for the appointment, oversight and management, and firing of 3<sup>rd</sup> party Fund Managers

Baron Kerslake  
Chair  
London Collective Investment Vehicle

Marcus Jones **MP**  
*Minister for Local Government*

*Department for Communities and Local Government*  
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16 JEF. 2016

*Dear Baron Kerslake,*

## **LONDON COLLECTIVE INVESTMENT VEHICLE (CIV): FINAL PROPOSAL**

I would like to thank you and all the authorities involved in the London CIV for your final proposal, which we discussed at our meeting on 12 December. I congratulate you on the savings already achieved since the London CIV became operational in 2015, and appreciate the hard work and commitment from elected members and officers which this represents.

It is now over a year since we set the framework for reform of the investment function of the local government pension scheme (LGPS), through the guidance and criteria for pooling published in November 2015. I am pleased that authorities across the scheme have responded to the challenge and come together to form partnerships of their own choosing based on a shared view of investment strategy. We do not underestimate the scale of the changes required, but the Government remains committed to pooling in order to deliver reduced costs while maintaining performance as well as to develop capacity and capability for greater investment in infrastructure.


I appreciate that overall costs are likely to rise in the early years, and that salaries are likely to be high for key senior roles within pool operators. But I consider that this is a price worth paying in order to achieve substantial savings, already estimated by the pools at £1-2 billion by 2033 or up to £200 million pa in the medium term. I am confident that as the reform beds in, there are further savings to be achieved.

I therefore expect every administering authority in England and Wales to participate in a pool. I also expect authorities to place all assets in their chosen pool, unless there is a strong value for money case for delay, taking into account the potential benefits across the pool. Individual funds will continue to be responsible for their investment strategies and asset allocation and will continue to require high standards of governance.

However I note that on current forecasts the transition of assets into the London CIV pool will be unacceptably slow. In order to deliver greater scale and the full potential for savings, I expect the participating funds to work with you to ensure faster progress on transition, and I will review progress in the spring. As many of the participating funds have raised the issue with me, I must also underline that funds may not use multiple pools in order to access a preferred investment manager. Pools may of course procure services from other pools, especially where a particular asset class is not yet available. On that basis I am pleased to confirm that I am content for you to proceed as set out in your final proposal.

Turning to the future, I appreciate there has been some delay this autumn, but I have no plans to extend the deadline for pools to become operational in April 2018. I will be reviewing progress of all the pools in spring and autumn 2017 and will expect to see a core team in place in spring 2017 and an application for Financial Conduct Authority authorisation, where not already in place, in autumn 2017. I look forward to seeing more detailed plans for delivering savings, and increasing your infrastructure investment in line with your stated ambition. I will also expect detailed plans for reporting, including on fees and net performance in each listed asset class against an index, standardised across the sector.

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**Mw**  
MARCUS JONE MIP 

Marcus Jones MP  
Minister for Local Government  
Department for Communities and Local Government  
4<sup>th</sup> Floor, Fry Building  
2 Marsham Street  
London  
SW1P 4DF

23 January 2017

Dear Minister,

**LONDON COLLECTIVE INVESTMENT VEHICLE (CIV): FINAL PROPOSAL**

Thank you for your letter of 16 December 2016 following our meeting on 12 December at which we discussed the final proposal submitted by London CIV and all our participating London authorities.

I am pleased to note that you are content for the London CIV arrangements to proceed as described in the submission, albeit with the caveat that you expect to see faster progress on the transition of assets than our latest plans forecast.

Everyone connected to the development of London CIV is proud of what has been achieved to date and there is strong commitment to building on the foundations that have been laid. We will continue to work with Members and colleagues across the London local authorities seeking to grow the assets under management as quickly as we can. However, this is a challenging process that requires proper consideration of long term value for money and recognition that developing the fund to provide the necessary range of investment opportunities is a complex and time-consuming process.

I also note your position that individual LGPS funds may not use multiple pools. As you say, many participating funds have raised this as an element of flexibility that they would wish to have. However, officers of London CIV engage with representatives of the other pools and, while it is not entirely clear how arrangements would work in practice, we will continue to consider options for collaborating across pools where benefit can be derived.

London CIV and our member authorities are keen to deliver pooling as fast as is practicable in a way that is consistent with securing best value. We are currently finalising our business plan and budget for 2017/18 and the medium term financial strategy for future years through to March

2022, once this is completed and agreed by our Board and members I will write again to provide an update on the final fund development proposals.

Finally, you will recall that Mark Boleat raised the issue of regulatory burden and costs that are imposing a significant drag on the benefits that London CIV is delivering. Not mentioned at our meeting but another area of significant concern are the changes being made to the Markets in Financial Instruments Directive (MiFID II). You will be aware that MiFID II will have the unintended consequence of downgrading LGPS funds from "professional" to "retail" status from January 2018. Not only will this change significantly impact on the way that LGPS funds invest but it will almost certainly completely undermine any hope that the government has of LGPS funds investing more in infrastructure. I would ask that you intervene with Treasury and the FCA on both of these issues.

I am copying this to all those colleagues that attended our meeting and will be formally providing your letter and this response to the next meeting of the London Councils' Sectoral Joint Committee.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'R W Kerslake', written in a cursive style.

The Lord Kerslake  
Chair

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