PSJC – 7 March 2018

Item no:6

Business Update Report

Report by:	Brian Lee	**Job title:**	COO
Date:	6 March 2018		
Contact Officer:	Brian Lee		
Telephone:	020 7934 9818	**Email:**	Brian.Lee@londonciv.org.uk

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Summary: The business update covers the following items:-

- A finance report covering the actual financial results for the ten months to January 2018 and an updated full year forecast
- A report on the regulatory capital including the pension guarantee required by City of London and the FRS102 recharge agreement
- An update report on the operating model and investment oversight tender
- A status report on fund launches and new business pipeline
- A report on the Richmond shareholding in LCIV

Recommendations: The PSJC is asked to note :-

i. the finance report

ii. the report on regulatory capital and the status of the guarantee and recharge agreement

iii. the operating model report

iv. the fund launch update

v. the Richmond shareholding in LCIV

I. Finance Report

LCIV is on track with the MTFS forecast submitted to the PSJC in December and ahead of the 2017/18 MTFS as previously noted.

The current forecast is £580k EBITDA compared to the MTFS of £69k. The variance is principally due to LGIM fees not budgeted and timing differences on expenses. Details of major variances are given below.

Income statement

	1H Actual	2H Actual+ Forecast	Full Year Forecast	MTFS	Variance	Notes
Service Charge	1,600	1,600	3,200	3,200	0	
Fund Income	601	744	1,345	1,251	94	
LGIM Fees	128	141	268		268	1
Total income	2,328	2,484	4,813	4,451	362	
Facilities	(157)	(181)	(338)	(359)	22	
Staff Costs	(858)	(1,368)	(2,226)	(2,318)	92	2
Legal & Professional	(383)	(907)	(1,290)	(1,231)	(60)	3
Travel & General Expenses	(12)	(20)	(32)	(67)	35	
Technology	(12)	(223)	(236)	(308)	73	4
Data Services	(56)	(56)	(111)	(110)	(1)	
Total Costs	(1,479)	(2,763)	(4,234)	(4,394)	161	
Net Profit	850	(279)	579	56	523	
Interest Income	4	(1)	3	15	(12)	
Depreciation	(1)	(1)	(2)	(2)	(0)	
Profit Before Tax	853	(281)	580	69	511	
FRS 102 Adjustment (est)			(1,146)		(1,146)	5
Net Adjusted Loss after FRS102			(566)			

Notes

1. As previously reported to the PSJC, the LGIM fees were not included in the previous MTFS. The LGIM fees are to be invoiced in April, reflecting the fees for the year. The PSJC is requested to agree the invoicing to be changed to twice a year to ensure that fees are being paid on a regular basis.
2. Staff costs are below budget due to lower headcount than budgeted.
3. Professional fees are higher than MTFS due to work involved in the governance review not fully budgeted in the MTFS and legal advice necessary for the Richmond/Wandsworth fund merger, legal work on the guarantee agreements for the City of London and the FRS102 recharge agreements.
4. As set out in the MTFS for 2017/18 and further explained in the 2018/19 MTFS, the operating model development began in October 2017 which was later than budgeted. Further details on the operating model are given later in this report.
5. As explained in the next section, the estimated additional FRS102 accounting liability provision for the pension scheme has been shown in the income statement. This provision does not involve any cash payments but an accounting estimate of future liabilities using a different set of assumptions to the Actuary.

The cash flow by quarter is given below. The large cash flows in Q1 and Q4 reflect the billing of the service charge and the DFC. As discussed at previous PSJC meetings, LCIV is not a capital intensive business and most expenses are on a monthly payment cycle but the build out of the business is reflected in the quarterly increase in expenses.

Cashflow	Q1 Actual	Q2 Actual	Q3 Actual	Q4 Actual+ Forecast
Service Charge	1,425	525	450	800
Fund Income	263	337	381	363
LGIM Fees				
Total income	1,688	862	831	1,163
Facilities	(72)	(85)	(106)	(75)
Staff Costs	(364)	(494)	(654)	(715)
Legal & Professional	(166)	(217)	(371)	(544)
Travel & General Expenses	(4)	(9)	(14)	(6)
Technology	(7)	(5)	(3)	(220)
Data Services	(27)	(28)	(24)	(32)
	-	-	-	-
Total Costs	(641)	(838)	(1,171)	(1,592)
Net Cash Position	1,048	24	(340)	(429)
Opening Cash Position	4,291	5,339	5,363	5,023
Closing Cash Position	5,339	5,363	5,023	4,594

The LCIV balance sheet contains a few key items:-

i. The cash position held for regulatory capital purposes in current assets
ii. The FRS102 provision which is a non-cash item
iii. The capital position which reflects the A and B shares including Richmond shares which is also commented on later in this report.

Balance Sheet	Actual Mar-17	Actual Jan-18	Forecast Mar-18
Non Current Assets	5	3	3
Current Assets	4,605	6,474	5,683
Current Liabilities	(300)	(1,223)	(823)
FRS102 Provision	(831)	(831)	(1,897)
Net Assets	3,479	4,423	2,966
Capital and Reserves	4,950	4,950	4,950
Profit and Loss Account	(1,471)	943	(1,984)
Net Capital	3,479	5,893	2,966

The table below shows the movement in AUM over the year to date. The Henderson Emerging Markets sub-fund was launched with January with a single borough investing £80m. There are now 11 sub-funds in the ACS, compared to 6 at the beginning of the year with assets having increased from £3.6bn to £6.3bn. The MTFS is forecasting a year end position of £7.2bn.

Funds	Mar	Apl	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
EPOCH Income Equity Fund	-	-	-	-	-	-	-	-	140	140	136
Henderson Emerging Markets Eq	-	-	-	-	-	-	-	-	-	-	79
Longview Global Equity Fund	-	-	-	-	282	378	376	436	436	442	448
Majedie UK Equity Fund	-	-	529	510	520	528	523	525	514	531	518
Newton Global Equity Fund	-	-	675	659	662	676	661	677	683	641	638
Newton Real Return Fund	333	334	341	346	341	343	343	345	345	344	337
Pyrford Global Return Fund	205	204	207	225	224	225	223	358	358	359	243
Ruffer Absolute Return Fund	413	413	478	473	467	539	539	582	583	834	830
Ballie Gifford Diversified Growth	356	358	363	362	358	432	434	475	475	477	481
Global Alpha Growth Fund	1,602	1,613	1,683	1,674	1,710	1,766	1,742	1,822	1,808	1,826	1,893
Global Alpha Equity Fund	667	667	691	691	699	720	715	731	735	742	749
Grand Total	**3,576**	**3,590**	**4,967**	**4,941**	**5,261**	**5,607**	**5,557**	**5,952**	**6,077**	**6,338**	**6,353**

II. Regulatory Capital

A significant amount of work has been undertaken to resolve the issue of the impact of the FRS102 pension deficit on the regulatory capital of LCIV. The PSJC will recall that from the MTFS presentation in January, the following table showed the impact of the pension deficit and the trading position of LCIV up to March 2018.

The PSJC is asked to note that LCIV's audited accounts 'locks in' the capital and reserves position until the following year. Assuming that the recharge agreements cannot be implemented by 31st March 2018, the FRS102 deficit would be carried through until July 2019. Accordingly, if LCIV were to achieve its MTFS target of £9.8bn of AUM by March 2019, LCIV is forecast to have a regulatory surplus of @£900k.

CAPITAL ADEQUACY	Actual Mar 2017 A	Actual Sep 2017 B	Forecast post audit Mar 2018 D	Forecast post audit and pension Mar 2018 E	Regulatory capital based on MTFS AUM Mar 2019 F
AUM	**3,575**	**5,557**	**7,277**	**7,277**	**9,789**
A = Initial Capital - Euro 125k	**106**	**110**	**110**	**110**	**110**
B = 0.02% of AUM in Excess of EUR 250 Mn	**673**	**1,067**	**1,411**	**1,411**	**1,913**
C = Quarter of Operating Expenses	**556**	**576**	**576**	**576**	**1,100**
Regulatory Capital Requirement	**779**	**1,177**	**1,521**	**1,521**	**2,023**
Share Capital	**4,950**	**4,950**	**4,950**	**4,950**	**4,950**
Retained Earnings	**-720**	**-720**	**-720**	**-720**	**-720**
FRS102 Deficit	**-751**	**-751**	**-1,897**	**0**	**-1,897**
Current Year P&L	**0**	**0**	**580**	**580**	**580**
Total Reserves Carried Forward	**3,479**	**3,479**	**2,913**	**4,810**	**2,913**
Surplus/Deficit Regulatory Capital	**2,700**	**2,302**	**1,392**	**3,289**	**890**

As previously advised to the PSJC, the two agreements have now been drafted and input has been requested from SLT to assist in the implementation. Initiated by Ian, a preliminary discussion took place with LFAC on 26th February which flagged a number of unspecified issues. Following the LFAC meeting, further discussion took place at an SLT meeting on 2nd March, the outcome of which at the time of this report unclear. A summary of the position is as follows:-

The guarantee proposal should be seen as implementing what was agreed in 2015 whilst signing the recharge agreement is a no cost action, frees up a large amount of capital and arises from the decision to offer the LGPS pension to LCIV staff.

Professional Advice taken

- Significant professional advice has been taken to ensure that LLAs do not increase their liabilities or costs when signing the guarantee and recharge agreements whilst achieving the aims of the City of London and LCIV.

Further Considerations

- The alternative to a written guarantee from each LLA would be an insurance bond. This was considered some three years ago but deemed cost prohibitive. This would become an annual LCIV running cost ultimately picked up by shareholders.
- The cost of the bond would prevent the Development Funding Charge being reduced as forecast in the MTFS and potentially increase the DFC per shareholder.
- During 2017, as part of the review of the existing pension provision, the LCIV Board agreed to cap the LGPS scheme to staff earning less than £120k.
- The recharge agreement is on an individual shareholder basis so there are 32 agreements, with each agreement on a several basis. The agreement needs to be signed by 31st March for it to be effective in the current year's accounts otherwise it will be rolled forward for 12 months.
- The guarantee agreement is an 'all shareholder' agreement which only becomes effective when the last shareholder signs. Any liabilities arising are on a several basis.
- Although Richmond's pension fund has merged with Wandsworth, Richmond's A share still exists and are still the legal owners and would need to sign the guarantee agreement for it to be effective.

Summary

The guarantee agreement formally addresses what was agreed in principle previously, in a cost effective way.

The guarantee and recharge agreements do not require the shareholders to commit any additional funding or costs beyond what was set out in the MTFS which has been approved by shareholders.

If the agreements are not signed there could be: -

- higher costs resulting from the cost of the bond preventing the reduction in the DFC per the MTFS and could be higher,
- a material reduction in regulatory capital which restricts the amount of assets managed. Note: capping assets managed means inevitably lower fee income which impacts the level of DFC
- if the scheme is forced to close and a s75 exit liability is triggered, the estimated s75 liability falls on LCIV impacting capital preventing LCIV from operating as an FCA regulated entity.

The PSJC is asked to note the impact of the FRS102 accounting deficit on the regulatory capital position of LCIV in the absence of recharge agreements being signed by 31st March2018 and the requirement of the City of London for a guarantee to be signed by all shareholders.

III. Operating Model

The table below sets out the current status of the three core IT projects. The client management information and client reporting projects are on track and on budget.
The investment oversight tender was issued on 19th February.

Progress vs Agreed Budget & Timelines

LONDON CIV

Ref	Project	Status	Timeline	On Budget	Description
1	**Discovery**	Complete	Complete	Complete	• Completed LCIV Target Operating Model Design (Phase 1a) **on plan** and **within agreed budget**
2	**CMI / Client Reporting Procurement**	Complete	Complete	Complete	• **Salesforce** procured as CRM solution • **Opus Nebula** as Client Reporting Solution • Contracts in place
3	**CMI Implementation**	In Progress	On plan	On Budget	• Implementing **Salesforce** as CRM • Additional (out-of-scope) functionality being included e.g. early stage **GDPR** compliancy workflows
4	**IIO Procurement**	In Progress	On plan	On Budget	• Changing LCIV strategy, in particular the focus on **Blended Asset Solutions**, has led to the need to revisit investment system requirements prior to OJEU submission • Additional **5 weeks** added into procurement for Bidder Dialogue to ensure most suitable vendor selected • Cost impact to be assessed **in April** – LCIV may opt for full or part time support during this period
5	**Client Reporting Implementation**	In Progress	On Plan	On budget	• Client Reporting Implementation in progress and **on plan** according to agreed timelines • ***Slightly over agreed budget due to the inclusion of additional reporting content and data*** • *Client reporting scope increased to include additional content in QIRs to meet more LLA requirements*
6	**CMI Processes**	To Be Confirmed / Scoped			• Subsequent sprints of CRM development (to be scoped)
7	**IIO Processes**	To Be Confirmed / Scoped			• Ongoing development of IIO processes, **exact scope to be agreed with Investments**
8	**IIO Implementation**	To Be Confirmed / Scoped			• Implementation of selected IIO system

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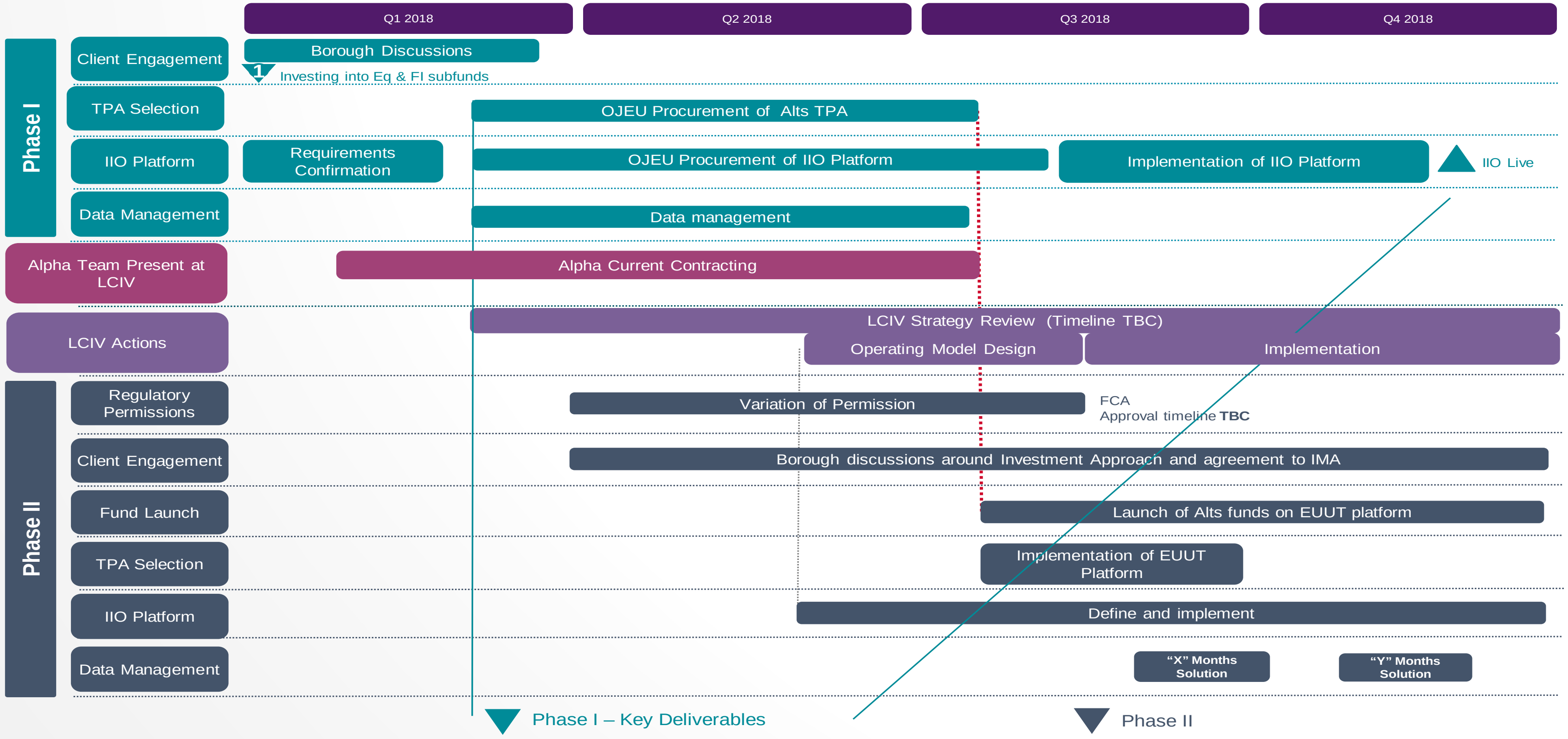
Project Timelines

The 2018 timeline focuses on building the platform and shaping the future operating model



Non-ACS fund platform

Following meetings with Eversheds to consider what is the most suitable platform for asset classes that don't naturally sit on the ACS (generally the more illiquid asset classes), Eversheds have been asked to confirm what is the most effective structure recognising that LCIV would like to future proof as far as possible. The recommendations are as follows:-

(a) a UK exempt unauthorised unit trust (**"EUUT"**) for its alternative investments, alongside its existing ACS; and

(b) the ACS for its equity investments, plus for the CQS mandate and, in the future, for asset classes where it is considered appropriate to do so.

In the event that the EUUT is launched this will not mean that the investments on the ACS are "transferred" across to the EUUT. Unless tax regimes change, the ACS will be the most tax efficient structure for a broad range of equity investments. This means that LCIV would be operating two separate structures, the ACS and the EUUT.

IV. Fund Launch & Third Party Administrator Update

- **RBC Sustainable** Fund was operationally ready to open September 21st. The fund will officially launch once we have subscriptions from the boroughs. Recent indications are Merton will be the seed investor with a £65mil subscription in early April.
- **CQS** LCIV, Northern Trust and the Depositary have worked through the majority of the operational and structural issues that have arisen in the design phase. The remaining challenge is trying to receive a price on the underlying CQS fund in time to price and accept subscriptions into our fund. Discussions are ongoing with Northern Trust, CQS and Eversheds. If there is a resolution within the week, fund launch is estimated to be towards the end of May.
- **PIMCO/ARES/MidOcean:** The fund launches are dependent upon procurement for a Third Party Administrator and borough demand. At this stage there is interest in PIMCO and MidOcean but no demand as of yet for ARES.
- **Third Party Administrator**: LCIV together with our advisor Mercer have had informal meetings with six potential Third Party Administrators to assess capabilities and receive pertinent information which helped to form the tender. The selection of the most appropriate administrator is critical for the future direction of LCIV. The administrator must have comprehensive capabilities to handle alternative asset classes, generic asset classes, blended solutions and the ancillary services LCIV would like to provide. Drafting the procurement is underway with the Invitation to Tender to be completed in early March and contract award mid-summer. In parallel, LCIV are in discussions with Eversheds and Deloitte on the fund and tax structuring options.

PIPELINE AS AT 28th February 2018				
Fund	**LLA**	**Level of interest**	**Estimated Date of Transition**	**Amount**
Baillie Gifford Alpha Growth	Ealing	Committee Decision made	April	197
Baillie Gifford Alpha Growth	Enfield	Committee Decision made	tbc	103
Baillie Gifford Alpha Growth	Waltham Forest	Committee Decision made	April	100
Baillie Gifford Alpha Growth	Merton	Committee Decision made	April	65
				465
Baillie Gifford Diversified Growth	Merton	Committee Decision made	April	**65**
Longview Global Equity	Enfield	Committee Decision made	tbc	50
Longview Global Equity	Waltham Forest	Committee Decision made	April	120
				170
Epoch Income Equity	Bexley	Committee Decision made	Funded March	85
				85
Ruffer Absolute Return	Camden	Committee Decision made	Split over Q1, Q2, Q3 2018	55
				55
Henderson Emerging Markets	Ealing	Committee Decision made	April	39
Henderson Emerging Markets	Enfield	Committee Decision made	tbc	35
Henderson Emerging Markets	Waltham Forest	Committee Decision made	April	80
				154
RBC Sustainable Equity	Hackney	Committee Decision made	April	180
RBC Sustainable Equity	Merton	Committee Decision made	April	65
				245
Pyrford Global Total Return	Merton	Committee Decision made		**33**
CQS	Haringey	Existing investor	tbc	75
CQS	Wandsworth	Existing investor	tbc	110
				185
BlackRock Passive	Hackney	Committee Decision made		**300**

Fund Launch Status Report

Fund Launch Status February 2018

Plan Phase	Vehicle Type	Fund	Current Launch Date	MTFS Launch Date	Launch £AUM (m)	MTFS £ AUM (m)	AUM vs. Plan and/or Commitments	Current AUM	Boroughs Indications of Interest / Comment
Global Equity Phase 1	Delegated/On Platform	RBC Sustainable	Apr'18	Sep '17	£180	£200	**-£20**	**£0**	**Hackney £180mil / Merton £65mil seed investor**
Global Equities Phase 2	tbc	Low Carbon Tracker	n/a	Dec '17	tbc	£150	**-£150**		
	Delegated/On Platform	RWC Global Horizons	tbc	Dec '17	tbc	£150	**-£150**		**Boroughs are accessing Low Carbon off platform via BlackRock & LGIM offerings.**
Fixed Income	Delegated or Unitised tbd	Global Investment Grade Credit: PIMCO	tbc	Mar '18	tbc	£300 per fund (on avg)	tbc		**Global Bond / Liquid MAC / Liquid Loans** **Fund Launch Dates contigent upon receipt of soft committments & onboarding of Third Party Administrator for funds on the new platform.** **CQS: £200m LLA will transition over. Fund Launch target May '18 subject to resolution of liqudity and pricing.** **Proposed Structure discussions with legal and tax advisors are ongoing.** **Finalise Product design and operational model.**
	Delegated or Unitised tbd	Liquid MAC CQS	May '18	Mar '18	£185		tbc		
	Delegated or Unitised tbd	Liquid MAC MidOCean (long/short)	tbc	Mar '18	tbc				
	Delegated or Unitised tbd	Private Debt: Liquid Loans ARES	tbc	July '18	tbc		tbc		
	Delegated or Unitised tbd	Illiquid MAC ARES	tbc	July '18	tbc		tbc		
					Total AUM	**£2bn**			

G: on track | A: AUM commitments delayed | R: No firm AUM commitments / impact: delayed fund launches | N: Fund structure & plan to be developed

V. Richmond and Wandsworth fund merger

Following discussions with Eversheds and Richmond, the status of the A and B shares owned by Richmond has now been established. The A and B shares were owned by the Richmond pension fund and following the Statutory Instrument issued to action the transfer, a number of decisions will need to be made with regards to the transfer and any potential request for redemption of the shares as the Shareholder Agreement did not anticipate the merger of funds and not the merger of authorities.

A detailed paper will be circulated shortly but the principle is that no redemption of A or B shares can take place without unanimous shareholder approval.

Brian Lee

6th March 2018