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CIPFA and BNY Mellon LGPS Pooling Seminar

21 March 2017





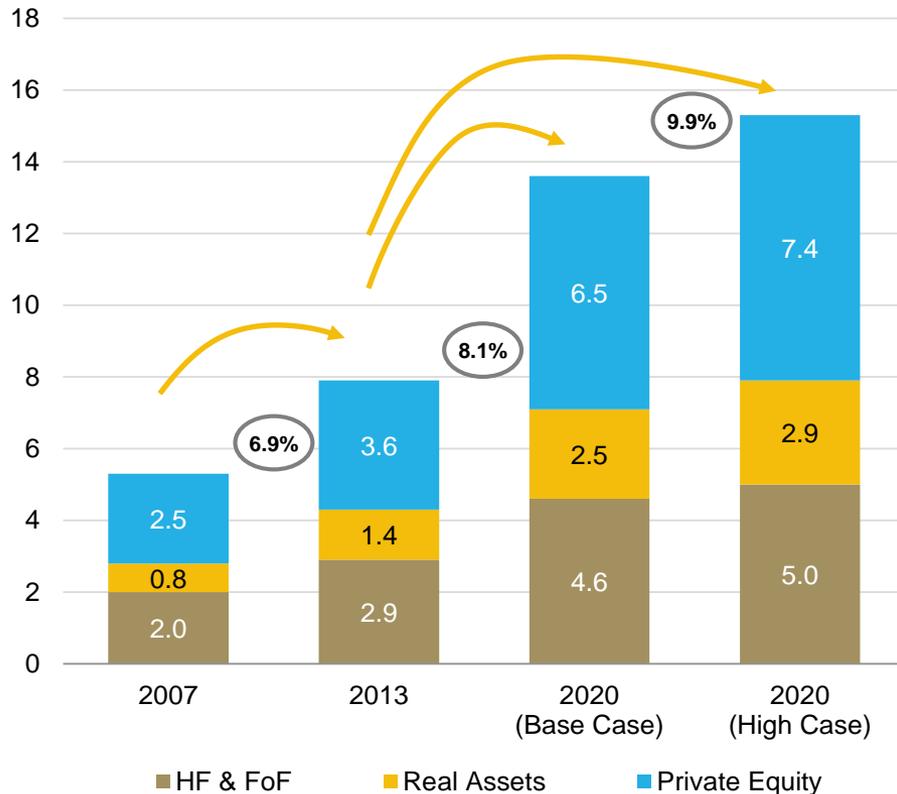
Brian McMahon

Relationship Development, Illiquid Assets

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Private Equity and Real Estate is mainstream

PwC 2020 Report – Estimated growth in alternatives



- Private Equity and Real Estate (PERE) valued at US\$6.3 trillion at the end of 2015
- PERE continues to exceed growth expectations, 10-12% CAGR
- Allocations to PERE have more than doubled since 2005
- McKinsey forecasts that alternatives will represent 15% of all global assets by 2020

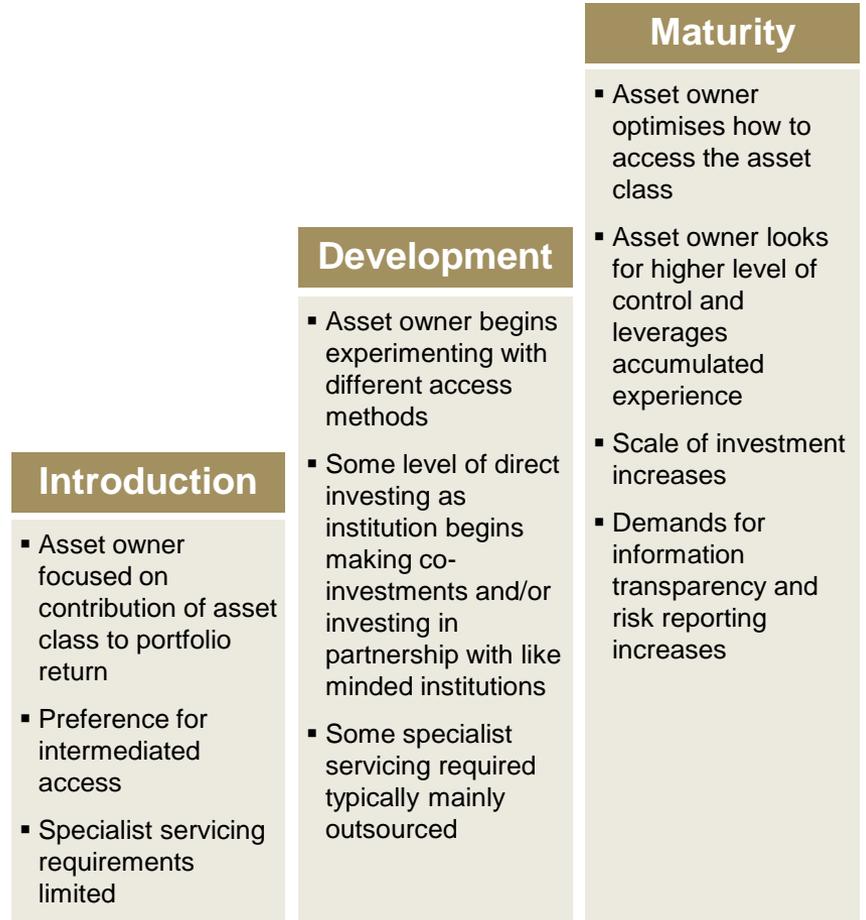
Drivers

- Performance challenges in face of low yield and uncertain economic growth
- Aging populations, with interest rates near zero, resulting in Pension funds increasing allocation
- Shift from DB to DC schemes
- Diversification requirements
- Higher Capital Adequacy Ratios
- Regulatory and Banking Reforms
- Relative volatility over the last two decades of traditional assets

How investors are reacting

- Significant shift in allocations from institutional investors
 - Wellcome Trust – 23% in 2005 to 47% in 2014
 - Echoed across pension funds, endowments, insurance companies
- With the greater allocations there is greater demand for transparency and control
 - Rise of co-investment scenarios
 - Demands for transparency reporting leading to enhanced portfolio monitoring
 - Increased focus on automation and sophisticated Risk Management
- Greater allocations giving greater influence
 - Fee negotiations
 - Segregated Mandates
 - ESG considerations
- Creation of LGPS pools allow schemes to develop operational framework in line with the above, and in accordance with government guidance on investment principles

Comfort with asset classes

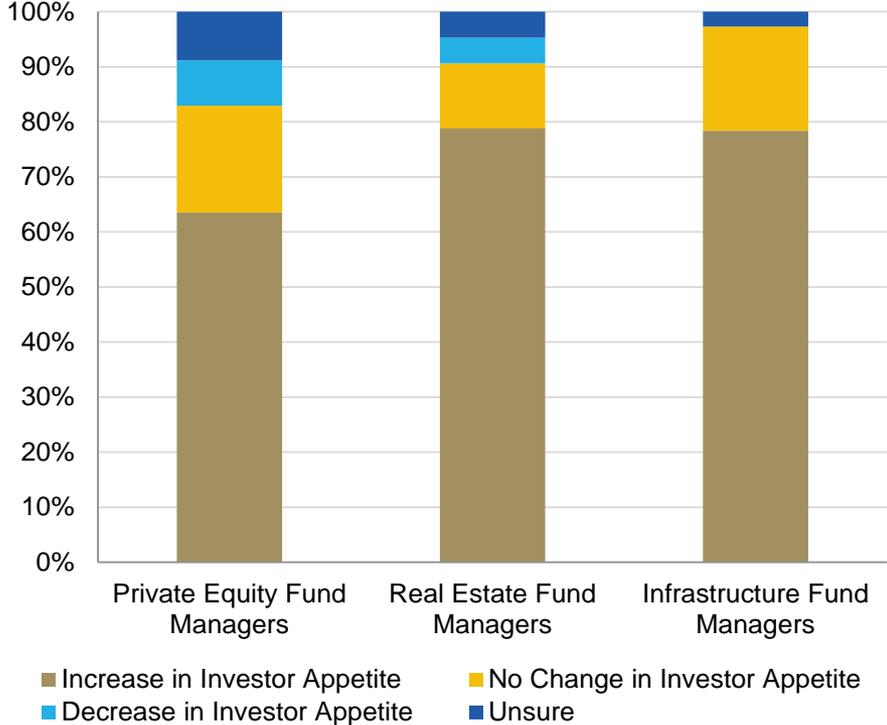


Experience with asset class

Growth in the industry

Fund Managers seeing increasing appetite from institutional investors

Change in institutional investor appetite over the last 12 months



Source: BNY / Preqin survey 2016

Institutional investors' plans for allocations in the longer-term



Source: Preqin Investor Outlook H1 2016

Illiquids within LGPS

- Fixed Income and equity allocations have reduced while Property, Private Equity and Infrastructure have increased

Asset	2013	2014	2015
Property PIV	3.4%	4.1%	4.1%
Property	2.4%	2.6%	2.7%
Private Equity	1.9%	1.9%	1.9%
Other	0.7%	0.7%	0.7%

Source: LGPS Board Annual Reports 2015/2014

- Real cash at work increased from GBP 15.19 billion to GBP 20.98 billion in this period
- By pooling funding together, Pension Schemes have access to greater range of funds, diversification, and fee negotiations
- Matching liquidity and strategic needs of schemes is important
- Review existing investments, stage of life-cycle and associated valuation

Organisation considerations

Structuring methods

- ACS or Traditional Partnership routes
- Fund administration requirements

Capital Call end-to-end management

- Pension Scheme is an investor into the Pool/Fund
- Structure must be set-up to allow for capital calls from underlying funds to be met on a timely basis
- Efficient cash management key

Contribution of existing assets

- Re-registration of assets
- Valuation of Contributed Assets
- Transfer of commitments

Further considerations

AIFMD Considerations

- Valuation rules – External Valuer vs Independent Internal Valuation Committee
- Depositary
- Reporting requirements

Risk Management

- AIFMD has specific rules around the duties of the AIFM in relation to Risk Management
- Needs to consider the specific nature of each investment, and whether accessed directly or indirectly
- Transparency requirements, and engagement with underlying managers for the provision of data

Asset selection

- Internal framework and investment committee structure, with skilled resources
- Historic performance still ranks as key criteria for investment decisions
- Ability of manager to provide information increasing in importance
- ESG reporting and impact of investment strategies in the region

Conclusion

- The creation of the pooled vehicles allows for greater bargaining power and diversity of investments. It is clear that the pools will continue to invest and will likely increase their investment in illiquid assets
- These assets require careful consideration, and appropriate operational framework and partners, but this development is in line with wider industry developments

David Walker – Hyman Robertson

“Resourcing is going to be a challenge for those pools setting up fund management organisations. There will be a demand for new roles such as risk officers, compliance officers and chief investment officers, and the market environment for these roles will be extremely competitive”

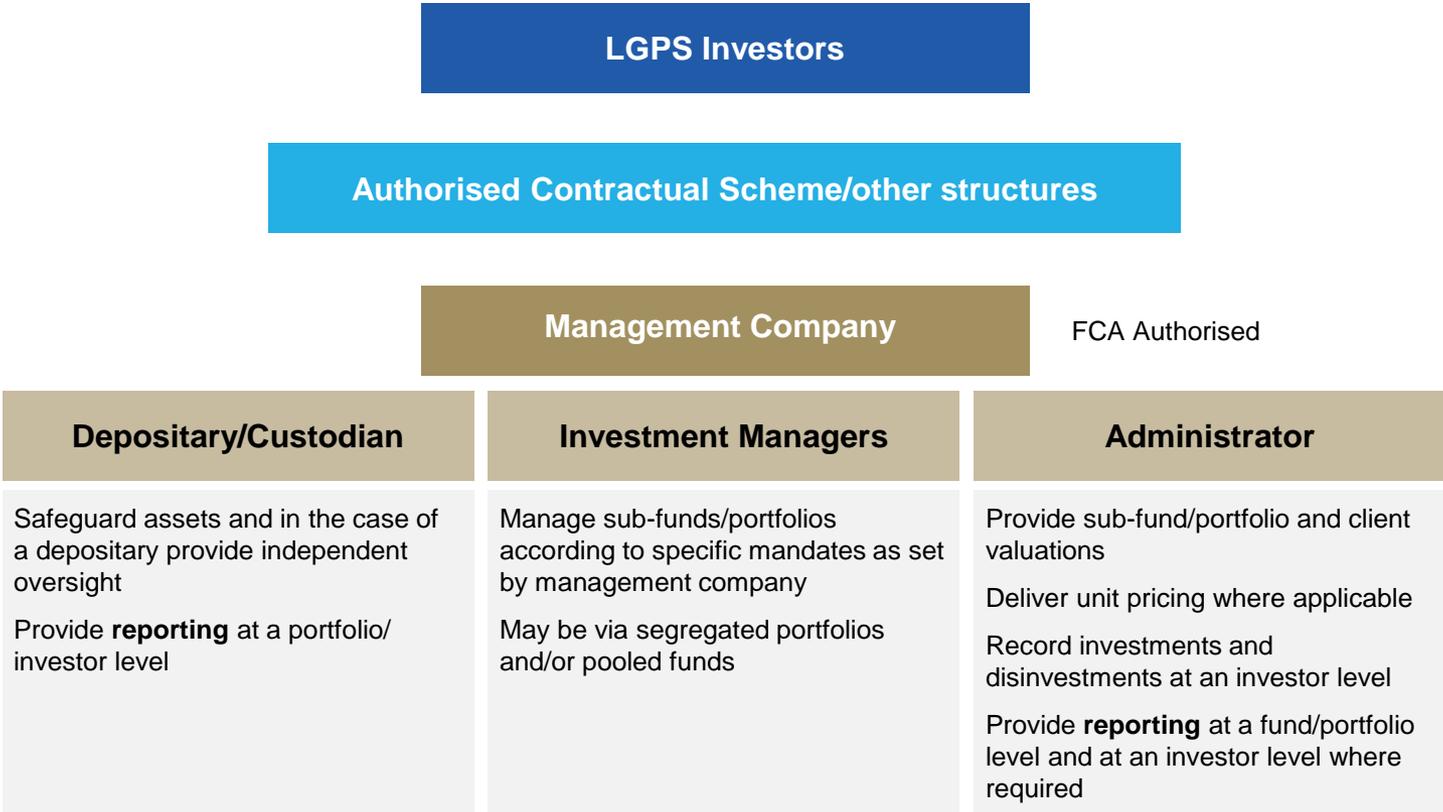


Dean Handley

Relationship Manager, UK Pensions

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ACS/other structures – To support LGPS investment pools



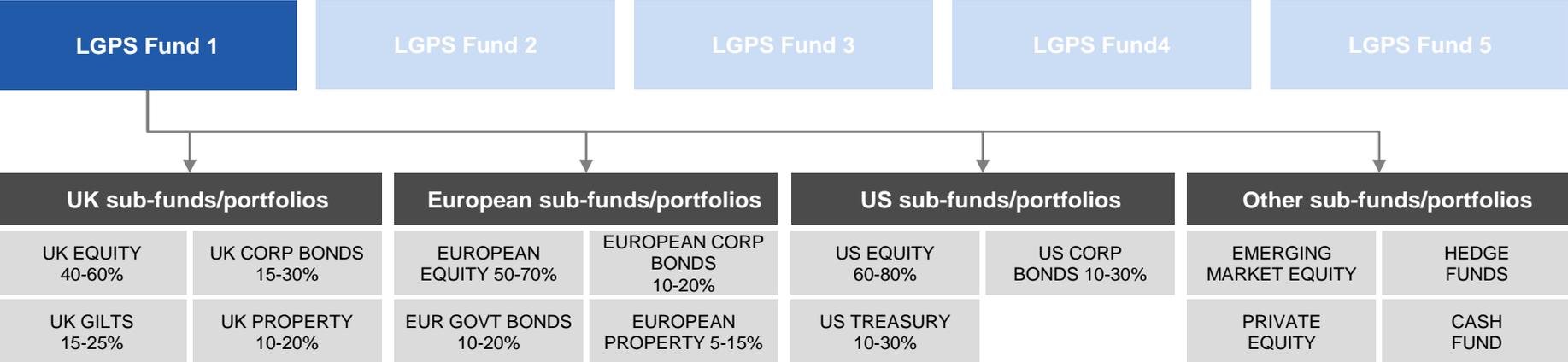
Example of proposed LGPS fund investment allocation

Sample asset allocation

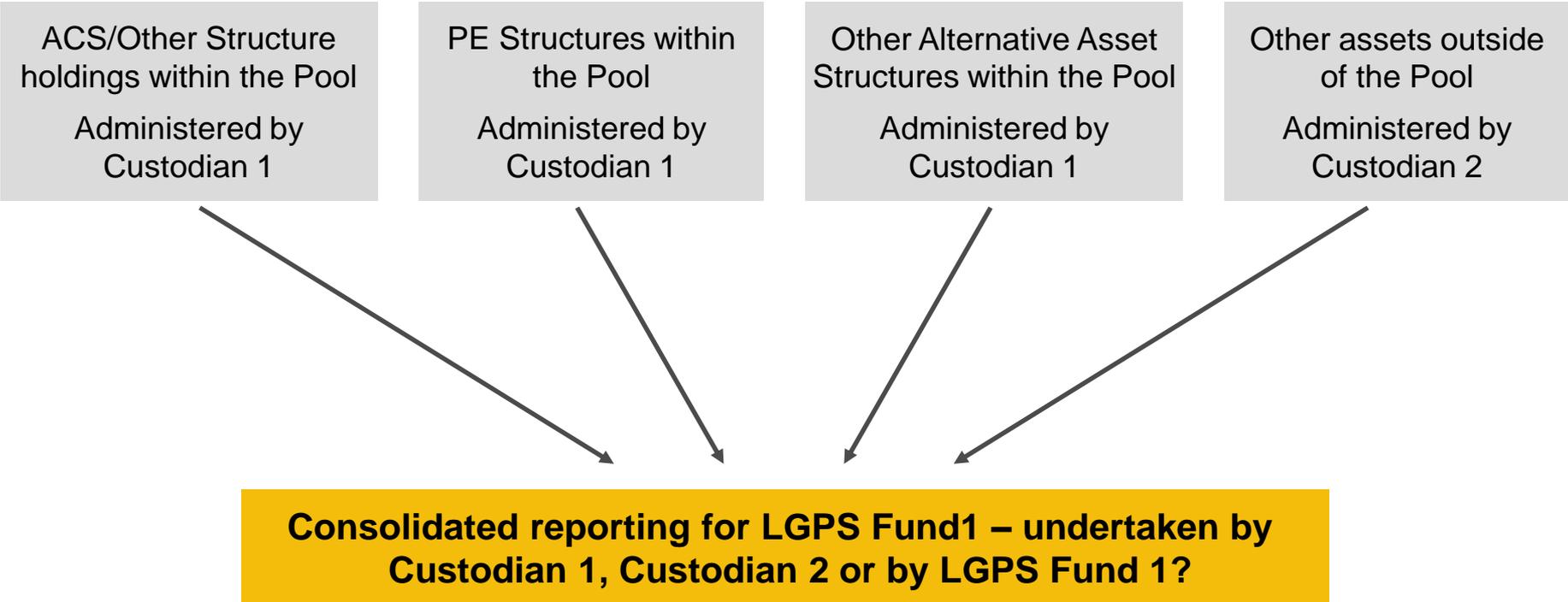
- Alternatives/Other – 10%
- US Equity – 10%
- European Equity – 24%
- UK Property – 3%
- UK Corporate Bonds – 18%
- UK Gilts – 1%
- UK Equity – 34%

Key

- LGPS Fund
- Sample Asset Class Sub-Fund/Portfolio
- Individual Scheme Asset Allocation



LGPS Fund 1



NB
Custodian 1 is the common custodian to the Pool
Custodian 2 is the custodian to LGPS Fund 1

Reporting needs

Who will need reporting and of what type and frequency will it be needed?

- **Management company** – will need to be able to deliver breakdown of assets held within the pooling structure of whatever type e.g. at total sub-fund/portfolio, at aggregate level, by investment manager, by investor, by asset class, etc.
- **Investors** – will need to understand what assets they hold within their chosen pool e.g. within an ACS sub-fund how many units does it hold and what is the look-through into the underlying assets? In a non-fund structure what percentage of a portfolio does that investor hold and what does that equate to in terms of individual holdings? Investors will need to consider how they will receive consolidated reporting i.e. to cover pool and non-pool assets
- **Joint Governance Committee** – will need detailed performance reporting to ascertain whether the sub-funds/portfolios are meeting the needs of the investors and to determine whether new funds or structure are needed

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