

Meeting of the

PENSIONS COMMITTEE

Thursday, 16 February 2012 at 7.30 p.m.

A G E N D A

VENUE

ROOM C1, 1ST FLOOR, TOWN HALL, MULBERRY PLACE

Members:

Chair: Councillor Anwar Khan
Vice – Chair: Councillor Zenith Rahman

Councillor Craig Aston
Councillor Aminur Khan
Councillor Rania Khan
Councillor Ahmed Adam Omer
Councillor Abdal Ullah
John Gray
Frank West

Deputies (if any):

Councillor Tim Archer, (Designated Deputy representing Councillor Craig Aston)
Councillor David Snowdon, (Designated Deputy representing Councillor Craig Aston)
Councillor Carlo Gibbs, (Designated Deputy representing Councillors Anwar Khan, Abdal Ullah, Zenith Rahman and Ahmed Omer)
Councillor Shiria Khatun, (Designated Deputy representing Councillors Anwar Khan, Abdal Ullah, Zenith Rahman and Ahmed Omer)
Councillor Mohammed Abdul Mukit MBE, (Designated Deputy representing Councillors Anwar Khan, Abdal Ullah, Zenith Rahman and Ahmed Omer)

[Note: The quorum for this body is 3 Members].

If you require any further information relating to this meeting, would like to request a large print, Braille or audio version of this document, or would like to discuss access arrangements or any other special requirements, please contact: Antonella Burgio, Democratic Services
Tel: 020 7364 4881, E:mail: antonella.burgio@towerhamlets.gov.uk

LONDON BOROUGH OF TOWER HAMLETS

PENSIONS COMMITTEE

Thursday, 16 February 2012

7.30 p.m.

1. APOLOGIES FOR ABSENCE

To receive any apologies for absence.

2. DECLARATIONS OF INTEREST (Pages 1 - 2)

To note any declarations of interest made by Members, including those restricting Members from voting on the questions detailed in Section 106 of the Local Government Finance Act, 1992. See attached note from the Chief Executive.

3. UNRESTRICTED MINUTES (Pages 3 - 6)

To confirm as a correct record of the proceedings the unrestricted minutes of the ordinary meeting of the Pension Committee held on 17 November 2011.

4. PETITIONS

To receive any petitions

5. MEMBER TRAINING

To receive a short training presentation on asset clarification and investment strategy.

6. UNRESTRICTED REPORTS FOR CONSIDERATION

6 .1 Report of Investment Panel for Quarter Ending 30 September 2011 (Pages 7 - 12)

6 .2 Report on Rebalancing Policy (Pages 13 - 16)

7. ANY OTHER UNRESTRICTED BUSINESS CONSIDERED TO BE URGENT

8. EXCLUSION OF PRESS AND PUBLIC

In view of the contents of the remaining items on the agenda, the Committee is recommended to adopt the following motion:

“That, under the provisions of Section 100A of the Local Government Act, 1972 as amended by the Local Government (Access to Information) Act, 1985, the Press and Public be excluded from the remainder of the meeting for the consideration of the Section Two business on the grounds that it contains information defined as Exempt in Part 1 of Schedule 12A to the Local Government, Act 1972”.

EXEMPT/CONFIDENTIAL SECTION (PINK)

The Exempt / Confidential (Pink) Committee papers in the Agenda will contain information, which is commercially, legally or personally sensitive and should not be divulged to third parties. If you do not wish to retain these papers after the meeting, please hand them to the Committee Officer present.

9. RESTRICTED MINUTES

17 - 20

To confirm as a correct record of the proceedings the restricted minutes of the ordinary meeting of the Pension Committee held on 17 November 2011.

10. ANY OTHER RESTRICTED BUSINESS CONSIDERED TO BE URGENT

Agenda Item 2

DECLARATIONS OF INTERESTS - NOTE FROM THE CHIEF EXECUTIVE

This note is guidance only. Members should consult the Council's Code of Conduct for further details. Note: Only Members can decide if they have an interest therefore they must make their own decision. If in doubt as to the nature of an interest it is advisable to seek advice **prior** to attending at a meeting.

Declaration of interests for Members

Where Members have a personal interest in any business of the authority as described in paragraph 4 of the Council's Code of Conduct (contained in part 5 of the Council's Constitution) then s/he must disclose this personal interest as in accordance with paragraph 5 of the Code. Members must disclose the existence and nature of the interest at the start of the meeting and certainly no later than the commencement of the item or where the interest becomes apparent.

You have a **personal interest** in any business of your authority where it relates to or is likely to affect:

- (a) An interest that you must **register**
- (b) An interest that is not on the register, but where the well-being or financial position of you, members of your family, or people with whom you have a close association, is likely to be affected by the business of your authority more than it would affect the majority of inhabitants of the ward affected by the decision.

Where a personal interest is declared a Member may stay and take part in the debate and decision on that item.

What constitutes a prejudicial interest? - Please refer to paragraph 6 of the adopted Code of Conduct.

Your personal interest will also be a prejudicial interest in a matter if (a), (b) and either (c) or (d) below apply:-

- (a) A member of the public, who knows the relevant facts, would reasonably think that your personal interests are so significant that it is likely to prejudice your judgment of the public interests; AND
- (b) The matter does not fall within one of the exempt categories of decision listed in paragraph 6.2 of the Code; AND EITHER
- (c) The matter affects your financial position or the financial interest of a body with which you are associated; or
- (d) The matter relates to the determination of a licensing or regulatory application

The key points to remember if you have a prejudicial interest in a matter being discussed at a meeting:-

- i. You must declare that you have a prejudicial interest, and the nature of that interest, as soon as that interest becomes apparent to you; and
- ii. You must leave the room for the duration of consideration and decision on the item and not seek to influence the debate or decision unless (iv) below applies; and

- iii. You must not seek to improperly influence a decision in which you have a prejudicial interest.
- iv. If Members of the public are allowed to speak or make representations at the meeting, give evidence or answer questions about the matter, by statutory right or otherwise (e.g. planning or licensing committees), you can declare your prejudicial interest but make representations. However, you must immediately leave the room once you have finished your representations and answered questions (if any). You cannot remain in the meeting or in the public gallery during the debate or decision on the matter.

LONDON BOROUGH OF TOWER HAMLETS

MINUTES OF THE PENSIONS COMMITTEE

HELD AT 7.30 P.M. ON THURSDAY, 17 NOVEMBER 2011

ROOM C1, 1ST FLOOR, TOWN HALL, MULBERRY PLACE

Members Present:

Councillor Anwar Khan (Chair)
Councillor Zenith Rahman (Vice-Chair)
Councillor Aminur Khan
Councillor Abdal Ullah
Frank West - Non-Voting Member (Trade Union) - Non-Voting Member (Trade Union)

Other Councillors Present:

Officers Present:

Anant Dodia	– (Pensions Manager)
Oladapo Shonola	– (Chief Financial Strategy Officer, Resources)
Jill Bell	– Head of Legal Services (Environment), Legal Services
Kate Bingham	– (Acting Service Head Resources, Children Schools & Families)
Lisa Stone	–
Antonella Burgio	– (Democratic Services)

1. APOLOGIES FOR ABSENCE

Apologies for absence were received from Councillors Craig Aston, Rania Kahn, Ahmed Omer and from Non-voting Member John Gray

2. DECLARATIONS OF INTEREST

No declarations of personal or prejudicial interest were made.

3. UNRESTRICTED MINUTES

The Chair **MOVED** and it was

RESOLVED

That the unrestricted minutes of the ordinary meeting of the Pensions Committee held on 21 July 2011 be approved and signed by the Chair, as a correct record of the proceedings.

4. PETITIONS

Nil items.

5. MEMBER TRAINING

Members of the Committee received training on the impact of the Hutton Review and implications of the Government's Comprehensive Spending Review on cash flow and fund maturity. The training was delivered by representative from Hymans Robertson Financial Services.

6. UNRESTRICTED REPORTS FOR CONSIDERATION

6.1 2010/11 Local Government Pension Fund Annual Report

The Chief Financial Strategy Officer presented the report circulated at agenda item 6.1. This contained that audited final pension fund statement of accounts for the period 2010/11.

The Committee was asked to

- a approve the pension fund statement of account
- b approve the pension fund annual report
- c approve the revised funding strategy statement

In his presentation the Chief Financial Strategy Officer highlighted following matters:

- the value of the fund had increased by 8% in the last year.
- performance of the fund relative to benchmark was mid – low range. This was because the pension fund had been configured for low risk.
- funding level had decreased over time because markets hadn't performed.
- membership of the fund had increased slightly.
- In last year, £40m had been received into the fund and £30m paid out resulting in a net positive inflow of £10m.
- cash flow would become narrower over the coming years.

RESOLVED

- 1. that the pension fund statement of account at Appendix 1 be approved
- 2. that the pension fund annual report be approved
- 3. that the revised funding strategy statement be approved

6.2 Hutton Commission Report

The Chief Financial Strategy Officer presented the report circulated at agenda item 6.2.

The Chair noted that the implications of the final report of the Hutton Commission issued in March 2011 had been discussed as part of the training given by Hymans Robertson earlier in the meeting. The Chair therefore moved that the report be noted without further discussion.

RESOLVED

That the report be noted

6.3 Report of Investment Panel for Quarter Ending 30 June 2011

The Chief Financial Strategy Officer presented the report circulated at agenda item 6.3. The Committee was informed that fund value / performance exceeded the benchmark in the last quarter and its value had increased by £10.8m.

In response to questions from the Committee, the following information was provided:

- The pension fund comprised seven fund managers. Schroders invest in property on behalf of the Fund, but have had to carry significant levels of cash through this year as they have not been able to find suitable investments for additional cash allocation that they have received. Their strategy is to invest in conservative properties which contained a rental income stream.
- Schroeder's property fund was looking for a 7% return over the next 12 months.
- It was noted that there had been underperformance in the previous year arising from the costs of property purchases.

RESOLVED

That the report be noted.

6.4 Review of Internal Control Report

The Chief Financial Strategy Officer presented the report circulated at agenda item 6.4 which contained the findings of a review of the adequacy of internal control measures put in place by pension fund managers.

Two fund managers (Schroeder's and Investec Asset Management) had been reviewed and no significant risk level increase was found. Risk levels had also been reviewed by auditors and it had been found that the risk level had not changed.

Internal control reports for other fund managers had now been received and were being reviewed. The outcomes would be reported at the next meeting of the Committee in February 2012.

RESOLVED

That the report be noted.

7. ANY OTHER UNRESTRICTED BUSINESS CONSIDERED TO BE URGENT

Nil items

8. EXCLUSION OF PRESS AND PUBLIC

Under the provisions of Section 100A of the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985, the Chair **moved** that press and public be excluded from the meeting during the consideration of the Section Two business on the grounds that it contained information defined as exempt in Part 1 of Schedule 12A of the Local Government Act 1972.

RESOLVED

That press and public be excluded for the consideration of the following item of business.

8.1 Academy Conversion - Recovery of Deficit

This item was considered in closed session.

The meeting ended at 8.22 p.m.

Chair, Councillor Anwar Khan
Pensions Committee

Agenda Item 6.1

COMMITTEE: Pensions Committee	DATE: 16 February 2012	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Corporate Director of Resources ORIGINATING OFFICER(S): Oladapo Shonola – Chief Financial Strategy Officer		TITLE: Report of Investment Panel for Quarter Ending 30 September 2011. Ward(s) affected: N/A		

Lead Member	Cllr Alibor Choudhury - Resources
Community Plan Theme	All
Strategic Priority	One Tower Hamlets

1. SUMMARY

- 1.1 This report informs Members of the activities of the Investment Panel and the performance of the Fund and its investment managers for the period ending 30 September 2011.
- 1.2 In the quarter to the end of September 2011 the Fund achieved a return of -9.2% which is 0.8% below the benchmark (-8.4%). The twelve month Fund return of -0.9% is in line with benchmark return, also at -0.9%. For longer periods, performance continued to lag behind the benchmark with the three years return at 5.0% only slightly behind benchmark of 5.4% and the five years return of 1.7% underperforming the benchmark return of 2.3% by 0.5%.
- 1.3 The performance of individual managers was mixed in the quarter due mainly to the sharp fall in equities. The absolute return managers seem to have been affected the most by the downturn in equities market, but the negative return was not restricted to this asset class.
- 1.4 Three managers matched or achieved returns above the benchmark whilst five were below. The variability of returns does however partially reflect the management structure of the fund where complementary investment styles reduce the volatility of returns.
- 1.5 The fall in the equities market over the quarter means that the Fund is modestly below its long term strategic equity asset allocation. However, the distribution of the Fund amongst the different asset classes is broadly in line with the benchmark.
- 1.6 A separate paper on the agenda proposes a rebalancing strategy that should ensure that actual asset allocation broadly reflects the agreed strategic asset allocation going forward.

2. DECISIONS REQUIRED

- 2.1 Members are recommended to note the contents of this report.

REASONS FOR DECISIONS

- 3.1 There are no decisions to be made as a result of this report. The report is written to inform panel members of the performance of pension fund managers and the overall performance of the Tower Hamlets Pension Fund.

ALTERNATIVE OPTIONS

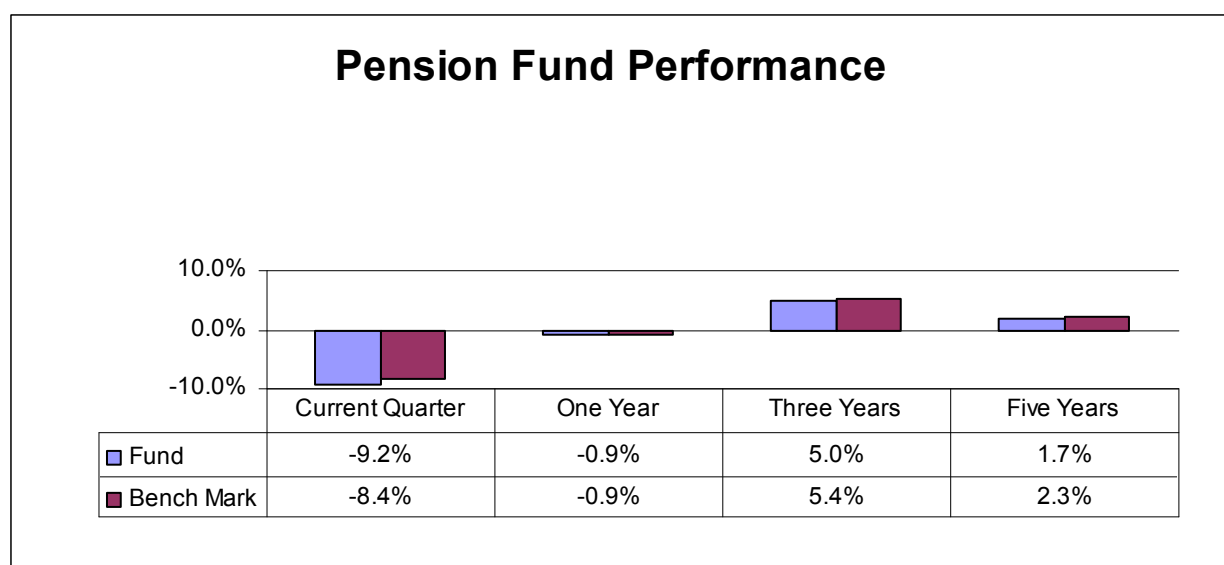
- 4.1 The Pension Fund Regulations requires that the Council establishes arrangements for monitoring the investments of the Pension Fund.

BACKGROUND

- 5.1 The Pension Fund Regulations require that the Council establish arrangements for monitoring the investments of the Fund and the activities of the investment managers and ensure that proper advice is obtained on investment issues.
- 5.2 This Committee has established the Investment Panel, which meets quarterly for this purpose. The Panel's membership comprises all Members of the Pensions Committee, an Investment Professional as Chair, an Independent Investment Adviser, and the Corporate Director of Resources represented by the Service Head Financial Services, Risk and Accountability, one trade union representatives and one representative of the admitted bodies. The Investment Panel is an advisory body which makes recommendations to the Pensions Committee which is the decision making body.
- 5.3 This report informs Members of the activities of the Investment Panel and performance of the Fund and its investment managers for the period ending 30 September 2011.

6 INVESTMENT PERFORMANCE

- 6.1 The Fund achieved a return of -9.2% which is 0.8%% below the benchmark of -8.4%.
- 6.2 The performance of the fund over the longer term is as set out in table 1.



- 6.3 The chart clearly demonstrates the volatility and cyclical nature of financial markets, but the outcomes are within the range of expectations used by the Fund actuary in assessing the funding position. The Fund can take a long term perspective on investment issues principally because a high proportion of its pensions liabilities are up to sixty years in the future. Consequently it can effectively ride out short term volatility in markets.

7. MANAGERS

- 7.1 The Fund currently employs eight specialist managers with mandates corresponding to the principal asset classes. The managers are as set out below:

Table 2: Management Structure

Manager	Mandate	Value £M	Target % of Fund	Actual % of Fund	Difference %	Date Appointed
GMO	Global Equity	177.9	25.0%	23.4%	-1.6%	29 Apr 2005
Baillie Gifford	Global Equity	115.5	16.0%	15.2%	-0.8%	5 Jul 2007
L & G UK Equity	UK Equity	144.7	20.0%	19.1%	-0.9%	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	39.5	5.0%	5.2%	0.2%	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	39.2	5.0%	5.2%	0.2%	8 Mar 2011
L & G Index Linked-Gilts	Bonds	42.7	3.0%	5.6%	2.6%	2 Aug 2010
Investec Bonds	Bonds	93.1	14.0%	12.3%	-1.7%	26 Apr 2010
Schroder	Property	94.3	12.0%	12.4%	0.4%	30 Sep 2004
Cash	Currency	11.8	0.0%	1.6%	1.6%	
Total		758.7	100.0%	100.0%	0.0%	

- 7.2 The fund value of £758.7 million held by the managers has decreased by £54.2 million (6.7%) over the quarter.
- 7.3 The performance of the individual managers relative to the appropriate benchmarks over the past five years is as set out in table 3.

Table 3: Manager Investment Performance relative to benchmark

Manager	Current Quarter	One Year	Three Years	Five Years
GMO	0.40%	1.50%	0.10%	0.30%
Baillie Gifford	-0.10%	0.50%	2.70%	2.20%
L & G UK Equity	0.00%	0.10%	N/A	N/A
Baillie Gifford Diversified Growth	-3.90%	-1.80%	N/A	N/A
Ruffer Total Return Fund	-2.30%	-2.40%	N/A	N/A
L & G Index Linked-Gilts	0.00%	0.10%	N/A	N/A
Investec Bonds	-4.10%	-3.60%	-4.50%	N/A
Schroder	-0.60%	-0.60%	-1.30%	-0.10%
Total Variance (Relative)	-0.80%	-0.00%	-0.40%	-0.60%

- 7.4 **GMO** modestly outperformed benchmark over the quarter. Although the Fund returned -14.9% due to its overweight position in European equities which was at the epicentre of the market collapse in this quarter as European equities underperformed global equities by 9%. Despite this loss and continue concerns about Europe, the manager has maintained the overweight position to Eurozone equities based on its belief that Eurozone equities are trading at up to 30% discount to global equities.
- 7.5 **Baillie Gifford** – the Fund performed in line with benchmark over the quarter with positive contributions in some aspects of the Fund being offset by losses in other areas. The make up of the portfolio of holdings remains largely unchanged due to the belief that the growth potential of holdings in the Global Alpha portfolio are largely independent of the macro environment, but more reliant on demand from exposure to geographical sectors such as emerging markets which is seen as robust still.
- 7.6 **L & G (UK Equity)** performance has been in line with the index benchmark (FTSE-All Share) since inception, as expected.
- 7.7 **L & G Index Linked Gilts** performance has been in line with the index benchmark (FTSE-A Index-Linked Over 15 Years Gilts) since inception.
- 7.8 **Schroder (Property)** Schroder underperformed benchmark over the quarter despite returning 1.1%. The European holdings and the impact of currency impact (depreciation of Euro against Sterling) within the Fund continue to adversely impact returns. The portfolio has undergone an intense investment phase over the past 12 months which by itself carries transactions cost – these investments have performed in line with benchmark.
- 7.9 **Investec (Bonds)** Investec had a very poor quarter. The manager admits that they had not envisaged the collapse in investor risk appetite that led to a very sharp sell off in corporate bonds. Although the manager took action to hedge some of the exposure to corporate bonds, and also hedged against currency this was not enough to off-set the impact of their misreading of the market.
- 7.10 **Baillie Gifford Diversified Growth Fund (Absolute Return)** performance this quarter reversed recent gains made by the Fund. The sale of equities significantly impacted performance although some of the negative impact from equities was offset by contributions from other areas such as gold and government bonds.
- 7.11 **Ruffer Total Return Fund (Absolute Return)** although performance was disappointing this quarter, the manager has stuck to its strategy of protecting assets first and seeking value over the longer term and expect that the portfolio's significantly exposure to equities will be rewarded in the long run.

8 ASSET ALLOCATION

- 8.1 The allocation of investments between the different asset classes was determined in conjunction with the Council's professional advisors in 2004 and is subject to periodic review by the Investment Panel – the latest review was carried out in January 2011. Asset allocation is determined by a number of factors including:-
- 8.1.1 The Risk Profile. Generally there is a trade-off between the returns obtainable on investments and the level of risk. Equities have higher potential returns but this is achieved with higher volatility. However, as the Fund remains open to new members and able to tolerate this it can seek long term benefits of the increased returns.

- 8.1.2 The Age Profile of the Fund. The younger the members of the Fund, the longer the period before pensions become payable and investments have to be realised for this purpose. This enables the Fund to invest in more volatile asset classes because it has the capacity to ride out adverse movements in the investment cycle.
- 8.1.3 The Deficit Recovery Term. All Council funds are in deficit because of falling investment returns and increasing life expectancy. The actuary determines the period over which the deficit is to be recovered and considers the need to stabilise the employer's contribution rate. The actuary has set a twenty year deficit recovery term for this Council which enables a longer term investment perspective to be taken.
- 8.2 The benchmark asset distribution and the position at the 30 September 2011 are as set out below:

Table 4: Asset Allocation

Mandate	Benchmark 31/09/2011	Fund Position	Variance as at 31/09/2011	Variance as at 31 Mar 2011
UK Equities	20.0%	19.1%	-0.9%	0.9%
Global Equities	41.0%	38.7%	-2.3%	-0.6%
Total Equities	61.0%	57.7%	-3.3%	0.3%
Property	12.0%	12.4%	0.4%	-1.2%
Bonds	14.0%	12.3%	-1.7%	-2.2%
UK Index Linked	3.0%	5.6%	2.6%	1.8%
Alternatives	10.0%	10.4%	0.4%	-0.2%
Cash	0.0%	1.6%	1.6%	1.5%
Currency	0.0%	0.0%	0.0%	0.0%
Total Equities	100.0%	100.0%		

- 8.3 Individual managers have discretion within defined limits to vary the asset distribution.
- 8.4 In addition the distribution will vary according to the relative returns of the different asset classes. Given that asset allocation imbalance is a consequence of the relative performance of different asset classes which can be dependent on the prevailing economic conditions at a particular time, it is important that a strategy is in place to periodically rebalance the portfolio to what has been determined to the agreed strategic allocation.
- 8.5 A separate report on the agenda proposes a long term solution to movement in asset allocation caused by relative performance of different asset classes and asks the Committee to agree a rebalancing strategy for the Fund.

9. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 9.1. The comments of the Corporate Director Resources have been incorporated into the report.

10. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

- 10.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 require the Council, as an administering authority, to invest fund money that is not needed immediately to make payments from the Pensions Fund. The Council is required to have a policy in relation to its investments and a Statement of Investment Principles. The Council is required to take advice about its investments.
- 10.2 The Council does not have to invest the fund money itself and may appoint one or more investment managers. Where the Council appoints an investment manager, it must keep the manager's performance under review. At least once every three months the Council must review the investments that the manager has made and, periodically, the Council must consider whether or not to retain that manager.
- 10.3 One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate, having regard to these matters, for the Committee to receive information about asset allocation and the performance of appointed investment managers.

11. ONE TOWER HAMLETS CONSIDERATIONS

- 11.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.
- 11.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

12. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 12.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

13. RISK MANAGEMENT IMPLICATIONS

- 13.1 Any form of investment inevitably involves a degree of risk.
- 13.2 To minimise risk the Investment Panel attempts to achieve a diversified portfolio. Diversification relates to asset classes and management styles.

14. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 14.1 There are no crime and disorder reduction implications arising from this report.

15. EFFICIENCY STATEMENT

- 15.1 The monitoring arrangement for the Pension Fund and the work of the Pension Fund Investment Panel should ensure that the Fund optimises the use of its resources in achieving the best returns for members of the Fund.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

<i>Brief description of "background papers"</i>	<i>Name and telephone number of holder And address where open to inspection</i>
<i>Review of Investment Managers' Performance for the 3rd Quarter Report 2011 – prepared by Hymans Robertson LLP</i>	<i>Oladapo Shonola Ext. 4733 Mulberry Place, 4th Floor.</i>

Agenda Item 6.2

COMMITTEE: Pensions Committee	DATE: 16 February 2012	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Corporate Director of Resources ORIGINATING OFFICER(S): Oladapo Shonola – Chief Financial Strategy Officer		TITLE: Report on Rebalancing Policy Ward(s) affected: N/A		

Lead Member	Cllr Anwar Khan, Chair of Pensions Committee
Community Plan Theme	All
Strategic Priority	One Tower Hamlets

1. **SUMMARY**

- 1.1 The London Borough of Tower Hamlets Pension Fund has multiple managers with varied performance at different periods during the economic cycle and environment. This can create an imbalance between target and actual asset allocation.
- 1.2 Although each manager has been allocated a proportion of Fund assets based on the strategic allocation that was originally agreed in 2004 and was recently reviewed in January 2011, there is often deviation from these allocations due mainly to the reason outlined in 1.1.
- 1.3 Rebalancing of the Fund is currently done on an periodic basis due to costs involved and other complications associated with transfer of assets from one manager to another. This report sets out an approach to rebalancing the strategic asset allocation and allocation to fund managers and allows a formal policy to be adopted on rebalancing.

2. **DECISIONS REQUIRED**

- 2.1 Members are recommended to adopt a formal rebalancing policy as follows:
 - 2.1.1 Use Legal & General (L&G) who currently manage two separate mandates (UK equities and index-linked gilts) as a swing manager in order to ensure that asset allocation within the portfolio remains consistent with that assumed in actuarial valuation.

3. **REASONS FOR DECISIONS**

- 3.1 The Local Government Pension Scheme (LGPS) (Management and Investment of Funds) Regulation 2009 requires an administering authority to invest fund money that is not needed immediately to make payments from the Pension Fund.
- 3.2 The Pension Committee is charged with meeting the duties of the Council in respect of investing pension fund assets having taken professional advice. Therefore it is appropriate that the Committee formally adopts a policy on rebalancing to ensure that the actual allocation of assets within the Fund reflects the target strategic allocation of assets.

4. ALTERNATIVE OPTIONS

- 4.1 The Council may choose not to adopt a policy on rebalancing, and instead continue to undertake ad-hoc review of asset allocation.

5. BACKGROUND

- 5.1 The current strategic allocation of assets was reviewed and a new set of benchmark was agreed and adopted in January 2011. Although, a review of target allocation is undertaken periodically, a formal process for rebalancing the portfolio in between reviews has not been agreed by the Committee.
- 5.2 It is expected as part of normal day to day management of a portfolio of assets that is as well diversified in terms of asset class and fund managers as the London Borough of Tower Hamlets Pension Fund is, that there will be a drift away from benchmark targets for each asset class due to deviations in performance between managers and also between particular markets (equities, bonds, properties, etc).
- 5.3 Rebalancing is considered a good discipline and has been shown to add value over time by taking profit from markets that have recently gone up and buying assets that have recently gone down. Value can also be added in that the strategic allocations to growth assets such as equities and property relative to low risk assets such as bonds is maintained in a way that allows returns to be in line with actuarial assumptions.

6 REBALANCING APPROACH

- 6.1 There are some issues with rebalancing allocations within a multiple manager Fund like London Borough of Tower Hamlets. These issues include:
- Complication around instructing multiple managers to transition assets to each other;
 - Delay between the date at which the allocation is measured and assets being rebalanced; and
 - Cost of buying and selling assets to rebalance to the benchmark.
- 6.2 A review of options has identified three approaches that could facilitate implementation of a rebalancing strategy with the Fund. They are as follows:
- 1 Regularly review allocations and instruct overweight managers to transition assets to underweight managers;
 - 2 Direct new cashflow to underweight managers to increase their allocation; and
 - 3 Utilise L&G swing manager service.

- 6.3 **Option 1** – Although instructing overweight managers to transfer assets to underweight managers is the most effective way of managing allocation to asset class and managers, it has significant drawbacks, including: the delay between getting up to date manager valuations and implementation; governance intensive in terms of monitoring of the allocation and instructing and coordinating manager trades; and transaction costs of transitioning assets between managers.
- 6.4 **Option 2** – Directing new cashflows to new managers although cheaper (as no requirement to realise assets before transfer can be facilitated and also in terms of governance and instruction), the net cashflow is only £500k per month. This equates to approximately 0.1% of assets, therefore negligible.
- 6.5 **Option 3** – this is the preferred option. L&G manage two separate mandates for the Fund, UK equities and index-linked gilts. If instructed, they could implement broad rebalancing of the allocation by monitoring the overall allocation of the managers and adjusting their allocation to either the UK equity or index-linked gilt fund to compensate for all managers who are above or below their strategic allocations – so it will be a net rebalancing for the whole Fund.
- 6.6 As swing manager for the Fund, L&G will have a mandate to monitor other manager allocations and automatically implement transitions within their own funds if ranges are breached.
- 6.7 The following practical issues should be noted as part of this arrangement being agreed:
- A swing mandate arrangement is only designed to quickly correct high level deviations in asset allocation between equities and bonds;
 - Asset allocation to index linked gilts would likely need to be increased by up to 2% to give more flexibility to the manager. Current allocation is 3%, but actual is closer to 5.8%;
 - A tolerance of +/-5% deviation from benchmark is reached before rebalancing is required and to rebalance to within +/-2%; and
 - L&G will charge a fee of £7,500 per annum for this service.

9. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 9.1. The comments of the Corporate Director Resources have been incorporated into the report.

10. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

- 10.1 One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate, having regard to these matters, for the Committee to receive information about asset allocation and the preservation of Fund assets.

11. ONE TOWER HAMLETS CONSIDERATIONS

- 11.1 Any losses arising from an imbalanced Fund relative to strategic asset allocation could impact on the Council through an increase in contributions in order to make good the Pension Fund's commitment to honour benefits that have been accrued by members of the Fund.
- 11.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

12. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 12.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

13. RISK MANAGEMENT IMPLICATIONS

- 13.1 The use of any form of investment inevitably involves a degree of risk - Although rebalancing will minimise the risk of significant deviation from the Fund's strategic asset allocation which is the basis of actuarial valuation.

14. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 14.1 There are no any crime and disorder reduction implications arising from this report.

15. EFFICIENCY STATEMENT

- 15.1 Rebalancing has been shown to add value over time, so should be considered a positive addition to that will help maximise returns.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"

*Name and telephone number of holder
And address where open to inspection*

Agenda Item 9

By virtue of paragraph(s) 2, 3, 4 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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