Non-Executive Report of the: **Pensions Committee** 29th November 2017	
Report of: Zena Cooke, Corporate Director, Resources	**Classification:** Unrestricted
Updated Investment Strategy Statement	

Originating Officer(s)	Bola Tobun, Investment & Treasury Manager
Wards affected	All wards

Summary

Following the 2016 actuarial valuation, the Pensions Committee initiated an investment strategy review. As a first step, the Pensions Committee received a scoping presentation at its meeting on 31st July 2017. The Committee's investment consultants, Mercer completed the strategy review which was presented to the Committee on 21st September 2017.

At the 21st September 2017 meeting, the Pensions Committee agreed that, in the interests of pursuing further diversification of the Fund's return seeking portfolio, and protecting its current buoyant equity asset value, further work be undertaken to achieve:

- an allocation to Multi-Asset Credit (MAC);
- downside protection with regard to equity risk; and
- Allocating to long-term illiquid asset classes (long lease, private debt and infrastructure.

Recommendations:

Pensions Committee are recommended to:

- note and approve the updated Investment Strategy Statement attached as Appendix 1 of this report; and
- agree an allocation of 6% to Multi-Asset Credit (MAC) in line with the investment strategy outcome presented by the investment consultant, Mercer, at the Pension Committee meeting on the 31st July 2017.

1. REASONS FOR THE DECISIONS

1.1 Following the outcome of the 2016 triennial revaluation of the Pension Fund, it is appropriate to consider the approach to both funding and employer contributions in order to determine whether the current investment strategy and strategic asset allocation remain appropriate for the Fund and its employers.

1.2 The Investment Strategy Statement (ISS) is a statutory document for LGPS funds, as required by Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. There have been two changes to the Fund's investment strategy since the last ISS was approved in March 2017; this report brings back an updated copy of the ISS incorporating these changes.

2. ALTERNATIVE OPTIONS

2.1 The Committee could decide to continue with its existing strategy. It is however, considered best practice to carry out an assessment of the Fund's position following the triennial valuation, even if the conclusion is to remain with the current strategy thereafter.

3. DETAILS OF REPORT

3.1 Under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Statement of Investment Principles has been replaced by the Investment Strategy Statement (ISS).

3.2 The ISS must be reviewed and revised by the Council as administering authority when any material changes take place such as changes to the types of investment held or the balance between the types of investments in the Fund. The updated ISS incorporates the below listed changes, to ensure that the ISS remains current.

3.3 In July 2017, in addition to the Committee's previous decision to terminate the mandate with GMO, the Global Equities mandate, the Committee agreed to increase the investment in the Council's Diversified Global Funds mandate from 10% to 20% by topping up the existing DGF fund mandates (Bailie Gifford and Ruffer) by 5% each.

3.4 At the September 2017 meeting the Committee agreed to:

- Decrease the Fund's allocation in Equities from 60% to 50%. This reflects an increase in the funding level and the level of risk concentrated in equities. The Fund's Adviser believes that the current strategy has heavy reliance on equities (c. 75% of expected return) and low exposure to cashflow-generative real assets.
- Removal of the dedicated UK equity allocation and switch to global equity exposure. This is due to the significant overweight position of the Fund in respect of UK Equity, relative to a market cap weighted index, and hence a materially lower allocation to the US and other regions.
- Allocation to Low Carbon global equities to represent 30% of total equity allocation, 15% of total Fund assets. A Low Carbon Passive Global Equity, which is designed to track broad market indices but with lower carbon footprints; in some cases significantly lower. Low carbon

indices can offer a relatively low cost solution to reducing exposure to carbon intensive companies.

- Allocation to passive global equities to represent 30% of total equity allocation, 15% of total Fund assets.
- Allocation to hedge 50% of the overseas currency exposure relating to the global equity allocation. As the Fund has benefitted greatly from lack of currency hedging, the Adviser believes there is an opportunity to bank some of these gains by introducing currency hedging.

Changes and addition in near term

3.5 The adviser presented and discussed the expected returns from Absolute Return Bonds (ARB), he believes these are very dependent on the skills of individual managers which are difficult to predict and is wholly reliant on the investment managers. The Adviser advocates a reduction of ARB allocation of 12% to 6% and believes that the reduced ARB allocation should be complemented by a 6% allocation to Multi-Asset Credit (MAC), where the returns are likely to be driven by markets rather than just manager skill.

3.6 The Adviser is in support of allocating more funds to index-linked gilts as these provide the only direct liability hedging in the current portfolio. Assuming that the current actuarial valuation approach is maintained, the Adviser would suggest increasing the exposure to index-linked gilts over time.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The Investment Strategy Statement details the decision by Committee on how the Fund's assets will be invested. The Strategy set has been prepared to maximise returns of Fund's assets within acceptable risk parameters and also to facilitate a reduction in the burden of deficit funding that employers in the Fund are liable for.

4.2 The performance of the Fund's strategy is monitored through a quarterly report that is presented to the Committee. Recent performances have been good and generally either in line with or exceeded target.

4.3 The report recommends that the fund allocate 6% (c.£80m) of the total fund value to a Multi-Asset Credit (MAC), diverting resources from the Absolute Return Bonds (ARB) portfolio. Currently total investment allocation in ARB is 12% of the Fund assets and this decision will mean a 50% reduction in investment in ARB.

5. LEGAL COMMENTS

5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 which govern the way in which local authorities are expected to deal with investment of pension funds. Local authorities should take a prudential approach to investment, demonstrating that they have given consideration to the suitability of different types of investment, have ensured an appropriately diverse portfolio of assets and have ensured an appropriate approach to managing risk.

5.2 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 ensure that funds are being managed in accordance with the Administering Authority's Investment Strategy Statement.

5.3 The Investment Strategy Statement must include those matters set out in Regulation 7(2) of the Local Government Pension Scheme (Management and Investment of Funds) Regulation 2016. Under Regulation 7(7) the administering authority must review and if necessary revise its investment strategy from time to time, and at least every 3 years, and publish a statement of any revisions.

5.4 The contents of this report and the recommendations set out ensure that the Administering Authority is compliant with the LGPS Regulations.

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 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.

6.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

7. BEST VALUE (BV) IMPLICATIONS

7.1 This report helps in addressing value for money through planning to have a rigorous and robust investment strategy in place to aid in bridging the Fund's funding gap.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

9. RISK MANAGEMENT IMPLICATIONS

9.1 Any form of investment inevitably involves a degree of risk.

9.2 To minimise risk the Investment Panel attempts to achieve a diversification portfolio. Diversification relates to asset classes and management styles.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

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

Linked Reports, Appendices and Background Documents

Linked Report

- [None]

Appendices

Appendix 1 – Updated Investment Strategy Statement, November 2017

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report

Officer contact details for documents:

- Bola Tobun Investment &Treasury Manager x4733