TOWER HAMLETS

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London Borough of Tower Hamlets – Initial Proposals to Government
Re: Investment Reform Criteria and Guidance

Dear Sirs

Local Government Pension Scheme: Investment Reform Criteria and Guidance
This is very much the initial response from the London Borough of Tower Hamlets to the criteria issued last November by the Department of Communities and Local Government (DCLG) which requires local authorities to respond by 19th February 2016, including a commitment to pooling and a description of progress towards formalising arrangements with other authorities.
A comprehensive response will be provided in time for the 15th July 2016 deadline.
Whilst we are fortunate in having made considerable progress in London, we would like to emphasise to Government that the scale of response required will entail considerable resources to provide a comprehensive answer at a time when Funds have to close accounts for 2015/16 as well as undertaking the triennial actuarial valuation.
As a shareholder in the London CIV, we believe that London Boroughs are able to demonstrate and deliver the Government's ambitious proposals for pooling early having set up the London CIV which is now fully authorised and already transition assets into the pool.

LB Tower Hamlets initial response in regard to the four criteria are stated below:

A. Asset pool(s) that achieve benefits of scale:

i. 31 London Boroughs have formally signed up as shareholders in the London CIV, assets under management as at 31st March 2015 amount to £27.6bn. If all London Borough were to participate this would mean that the London CIV assets pooled could be in the region of £29.1bn. Clearly investment markets over the period since then have been volatile and therefore assets may fall short of the above numbers. Our position as the Administering Authority of an individual fund has been to participate in the CIV and we continue to believe that this is the most appropriate pool for the Fund to collaborate with.
ii. Whilst it will undoubtedly take time to open individual funds on the CIV and for Boroughs to transition assets into the CIV, we believe that the London CIV would reach the critical quantity to achieve scale of benefits.
iii. London CIV is currently undergoing what is called Phase 1 – Implementation and fund launch to deliver nine sub-funds. Almost a quarter (£260m) of our Fund assets will be transitioned to the CIV platform before the end of February 2016; this is a demonstration of the council commitment to London CIV pooling arrangement.

iv. Even If it is assumed that at least 90 per cent of borough assets will eventually be invested through the CIV (recognising that some boroughs may have illiquid assets such as infrastructure and private equity or may wish to make the case for up to 10 per cent of their assets to remain outside of the CIV, investing with niche fund managers with no capacity to be on the CIV platform) then the government's threshold of each pool having assets of at least £25 billion will be met.

v. In terms of establishing the London CIV, this has been undertaken by a combination of internal and external resources and we would anticipate that this would continue as the CIV develops, although we anticipate that internal resources within the CIV itself will grow.

vi. The London CIV has been keeping DCLG informed of progress and is content to continue to do so. Individual funds have also kept their Pensions Committee informed of progress, with Chairs or Vice Chairs of Pensions Committee being Members of the Pensions Sectoral Joint Committee (PSJC).

B. Strong Governance and decision making:

i. Government will be aware of the structure that the London CIV has established which includes the Pensions Sectoral Joint Committee (PSJC - comprising of London Pension Fund Chairs and Vice Chairs) as well as an Investment Advisory Committee (IAC - comprising of officers of the London funds) and that this helps to main the strong links and assurance with the local administering authorities. This ensures that the links with local democratic accountability for the London CIV are maintained. The PSJC agendas and minutes are also publicly available which enables external scrutiny of the work of the PSJC.

ii. The company and fund structure chosen for the London CIV means that the company has to be accountable to its shareholders who all retain equal shares in the ownership and voting.

iii. As government will be aware the London CIV pool already has dedicated resources working for the company with a Chief Executive, Investment Oversight Director, Operations Director as well as support staff. In addition the Company has a highly respected Non-Executive Board in place meeting the requirements for strong governance arrangements to be in place.

iv. In addition the arrangements that the London CIV has already put in place with external providers including Northern Trust (asset service provider), Capita (operating model adviser) as well as having used expert advisers, Eversheds and Deloitte in the establishment of the CIV provides administering authorities with the assurance on both the set-up and ongoing operation of the London CIV.

v. With regards to providing assurance on environmental, social and governance issues and how this will be handled by the pool, this has already been the subject of consideration by the company and the PSJC with an agreement that the London CIV should be a separate member of the Local Authority Pension Fund Forum (LAPFF) – a body which represents the majority of views of local authority pension funds on these matters.

vi. The London CIV is also currently considering how it will meet the requirements of the Stewardship Code and anticipates being a signatory to this in due course.

vii. The IAC has also established a working group to look at the whole issue of ESG matters and how funds can best access this through the London CIV and how to assist funds in acting as long term responsible shareholders.

viii. For individual funds, we will of course need to maintain our own policies in respect of ESG matters and this will comprise part of our new Investment Strategy Statement which replaces the Statement of Investment Principles later this year.

C. Reduced costs and excellent value for money:

i. As an early participant in collaboration via the London CIV, the Fund has been keen to explore opportunities for fee savings from collaboration in addition to fee negotiations with individual managers outside this process.

ii. We anticipate significant fee savings arising from the CIV over time, from scale and improved negotiations with managers. The first phase of the CIV looks to be delivering fee savings close to £3m p.a. for the funds that will be invested, whilst it is has to be recognised that the first phase represents relatively low cost asset classes with the majority being in passive asset classes. We expect that as more complex and expensive assets are added to the CIV that the fee savings will significantly increase over time.

iii. In addition to the anticipated fee savings, we also expect wider governance benefits from information sharing and improved access to expertise at all levels. The PWC report for the Society of London Treasurers in 2012 estimated that an additional £85m could be delivered in terms of improved investment returns by delivering superior performance. Whilst clearly this is a figure which is open to some discussion, it does give an indication of what might be achieved for funds by greater collaboration and delivering improved performance across all funds.

iv. Whilst recognising that 2013 could be considered as a starting point for when funds started to apply pressure to managers for fee reductions, funds have always been conscious of the need to deliver value for money and this has included fee negotiations both at the outset of the contract and also ongoing reviews and that is certainly the case for our fund.

v. Funds clearly understand the need to look at the risk adjusted returns over the longer term and that it is the net value add that impacts on the fund's ability to pay pensions over the longer term. However, we remain very conscious to avoid knee jerk reactions when managers experience periods of underperformance and we are pleased to see the government has recognised this in asking for funds to consider what is achieved over an appropriate longer term, rather than solely focusing on short term performance comparisons.

D. An improved capacity to invest in infrastructure:

i. Funds across London currently hold little to no infrastructure assets and as a Fund we are no exception to that. Having limited resources to consider this asset class along with a perceived lack of suitable investments means that limited consideration has been given to this asset class. Being part of a larger pool with the capacity to look at these investments and to provide suitable opportunities for individual funds will mean that both we and other funds in London will have a greater capacity to invest in infrastructure.

ii. Having scale of assets will enable the CIV to look at opportunities for infrastructure, either direct or as co-investments that would not have been open to us as an individual fund.

iii. Determining the proportion of assets that the fund will invest in infrastructure in the future will depend on the opportunities that are available and will depend on the level of risk and reward available from those assets when compared against risk/reward in other asset classes.

iv. However, as part of the pool, the fund's capacity to invest will be significantly increased both from a scale and knowledge perspective and the Pensions Committee will therefore be in a position to allocate assets in this area. Assuming that there are assets available with the right risk/return profile, there is no reason why the Fund would not be in a position to invest to a level comparable with international larger scale funds.

In Conclusion

We believe that the work that has been undertaken by the London Boroughs that have contributed to the development of the pool in London, the London CIV has been instrumental in driving forward the investment reform agenda in London. The scale of assets that we anticipate will be achieved in London is sufficiently large for the London CIV to meet one of the criteria for scale of £25bn over the timescales being required. We believe that we have developed both the appropriate structure for London funds and that the governance structures in place mean that local accountability and decision making on asset allocation are retained.

Consequently we strongly believe given the willingness and progress that London funds have made over the last 2 years means that we are able to meet the criteria under the government's reform agenda.

We recognise that further work is required, but that as funds we are in a strong position to be able to come forward with comprehensive proposals to meet the government's criteria and guidance when submitting these in July 2016.