Non-Executive Report of the: **Pensions Committee** 22nd September 2016	TOWER HAMLETS
Report of: Zena Cooke, Corporate Director of Resources	**Classification:** Unrestricted
Investment Strategy Plan after 31st March 2016 Triennial Valuation	

Originating Officer(s)	Bola Tobun, Investment & Treasury Manager
Authorising Officer(s)	Neville Murton, Service Head of Finance & Procurement
Wards affected	All wards

Summary

This report provides a summary of the need to review the current investment strategy following the 2016 Triennial Actuarial Valuation outcome and other relevant issues such as the current investment climate.

The review will encompass an asset liability study which assesses the suitability of alternative investment strategies for the pension fund's liability profile; the longer the term until pensions become payable the higher the investment risk which can be accommodated by the fund.

This would be supplemented by a sophisticated modelling exercise which will set out the risk/ reward trade-off for alternative investment strategies.

Recommendations:

Members are recommended to:

Note the contents of this report.

1. REASONS FOR THE DECISIONS

1.1 As the 2016 valuation outcome approaches it is appropriate to consider the approach to funding and employer contributions in order to consider whether the current approach is likely to remain so for the Fund and its employers.

1.2 The Pensions Committee's role means that they need to ensure that there are realistic strategies in place to meet funding goals, that strategies are affordable, prudent and provide stability for employers in the Fund. Understanding the impact of adopting different approaches to the investment strategy and the setting of employer contribution strategies enables the Committee to consider the longer term financial impact of such decisions and to take reasonable financial decisions when setting investment and contribution strategies.

2. ALTERNATIVE OPTIONS

2.1 No alternatives have been considered at this stage. The Committee could decide to continue with its existing strategy however, it would be considered best practice to at least carry out an assessment of the Fund's position following the triennial valuation, even if the conclusion was to remain with the current strategy thereafter.

3. DETAILS OF REPORT

3.1 This report sets out the need to review the current investment strategy in light of the 2016 Triennial Actuarial Valuation outcome.

3.2 The Triennial Valuation cycle provides a good point at which to review the investment strategy as the Fund will have a current valuation of the liabilities of the Fund. The changes in funding level between one valuation and the next is effectively the best measure of how the Fund's liabilities are developing in comparison to changing bond yields in the market; widely considered to be the best measure of asset return that match those of the Pension Fund liabilities.

3.3 The Fund's current investment strategy was agreed following the review in 2004, and although the strategy has been revised a number of times since it was implemented the overall balance between growth seeking assets (83%) and lower risk matching assets (17%) has remained broadly similar to that agreed in 2004.

3.4 The Fund is currently starting a procurement exercise for the Fund's Investment consultant and it is intended that the successful provider will be commissioned to undertake an investment review shortly after appointment.

3.5 The successful investment consultant will look at a range of investment issues and also work closely with the Fund actuaries to model the probability of the Fund achieving its funding targets with a range of investment strategies and use these to formulate a de-risking strategy. The Fund at this time maintains a relatively high risk strategy (83% growth assets) on the basis that growth assets will deliver outperformance enabling the Fund to close the funding gap over a period of time.

3.6 The investment review will also provide the Committee with an update on the Fund's existing manager's performance.

3.7 The Pensions Committee will be provided with information during 2016/2017 on the following topics:

a) Liability Driven Investment - LDI is an investment style that seeks to match the movements in the value of a Fund's liabilities with a basket of investments whose value will be affected by prevailing bond yields in exactly the same way as the value of the Fund's liabilities. Due to the historic low yields at present, an attempt to match all of the Fund's liabilities would be considered very expensive; however, the decision to match a scheme's inflation-linked liabilities is much more attractive, especially for the LGPS as there are direct inflation linkages to the pension liabilities.
Setting up this mechanism could put the Fund in a better position where it could react relatively swiftly to capture what would be considered attractive future de-risking opportunities. Without the appropriate structure in place, the opportunity to de-risk when opportune could easily be missed. An opportunity to de-risk after the valuation of 2007 was generally missed by LGPS Funds.

b) Infrastructure Debt - There are benefits for LGPS funds to take on infrastructure investments. On the upside, infrastructure has the potential to offer stable, transparent and inflation-linked cashflows in order to address the inflation-indexed liabilities of the fund. The major drawback of the asset class is the illiquid nature of the investment, and the fact that funds are tied up for the long term.

c) Diversified Growth Funds - Further venture into DGF will assist with further return diversification and improved risk management.

d) Leveraged Gilt Portfolio - A leveraged gilt portfolio will provide protection against future movement in interest rates and inflation. There will be an emphasis on putting the platform in first with a view to building up the allocation over time, based on funding improvements and also as real yields increase.

e) Synthetic Equities - It is likely that commitments to protection assets will be funded from passive equity portfolios. A synthetic equity portfolio will bridge this gap and retain the commitment to active growth assets.

f) Smart Beta - Smart beta strategies attempt to deliver a better risk and return trade-off than conventional market cap weighted indices by using alternative weighting schemes based on measures such as volatility or dividends. Smart beta refers to an investment style where the manager passively follows an index designed to take advantage of perceived systematic biases or inefficiencies in the market. It therefore costs less than active management, since there is less day-to-day decision-making for the manager, but since it will, at the very least, have higher trading costs than traditional passive management (which minimises those costs), it is a pricier option.

3.10 There are many advantages in undertaking a review of the investment strategy, which can be summarised as follows:

a) It will define the parameters within which the investment decisions can be made i.e. eliminates the extremes.

b) Provide a context for Members to consider the risk they are willing to assume for investment issues.

c) Provide an assessment of whether the current strategy which was devised in 2004 remains appropriate in the current investment environment.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The comments of the Corporate Director Resources are incorporated in the report

5. LEGAL COMMENTS

5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, Regulation 11 requires Administering Authorities to formulate a policy for the investment of its fund money and be formulated with a view:
(a) to the advisability of investing fund money in a wide variety of investments; and
(b) to the suitability of particular investments and types of investments.

5.2 The regulations further require the Administering Authority to invest in accordance with its investment policy, having obtained proper advice at reasonable intervals about its investments and considered that advice before making any decisions.

5.3 There are currently draft regulations – The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 which will govern the way local authorities are expected to deal with investment of pension funds. The new regulations will largely replace the 2009 regulations. No date has been set for the commencement of these regulations. The main thrust of the Regulations will be for local authorities to 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.

5.4 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.

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

5.6 When performing its functions as administrator of the LBTH pension fund, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the

need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty).

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

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