

Non-Executive Report of the: Pensions Committee 24 th July 2018	 TOWER HAMLETS
Report of: Zena Cooke, Corporate Director, Resources	Classification: Unrestricted
Equity Protection Strategy Investment Manager Search	

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

Summary

Authority delegated to CFO at the March Committee meeting to seek and implement an Equity Protection Investment

This report provides an update on the action taken in relation to the Equity Protection Investment. Work was carried out supported by the Fund Consultant, Mercer, and the Independent Adviser to put in place an Equity Protection Investment for the Fund.

The aim of the investment being to reduce the risk to the fund of its exposure to investments in equities.

Funding Level at 2016 Formal valuation was 83% and update as at 31st March 2018 was 85%

This investment strategy is required, in order to provide more certainty around the outcome of the 31st March 2019 formal actuarial valuation and protect against the risk of a significant fall in equities given increased volatility in markets and concerns regarding stretched valuations. The funding level remains strong since the last valuation, so the Fund would be implementing an equity protection strategy from a position of relative strength.

We undertook a Market Review with assistance from Mercers

Market is small, four of the known six main providers already manage funds for LBTH

Using one of the four enables swift implementation of solution. Other two providers known to be less interested in this type of mandate

Of four existing managers, one declined to submit for this mandate (GSAM)

The other three submitted, initial review carried out by Mercer Ltd, presented to officers. New Independent Adviser (Colin Robertson) was consulted and supports both the approach and the manager selected.

Recommendations:

Pensions Committee are recommended to:

- note the process undertaken to select an Equity Protection Investment Option to offer some protection against a fall in the value of the fund at the next valuation date of March 2019 and the decision made by the CFO under the authority that was delegated.

1. REASONS FOR THE DECISIONS

- 1.1 The Council has an overarching responsibility to maintain the Pension Fund. It is essential that the Fund has the right range of investment managers and products to support the Pensions Committee to discharge its responsibilities.
- 1.2 Within the terms of reference for the Pensions Committee, they are required to 'to make arrangements for the appointment of and to appoint suitably qualified pension fund administrators, advisers, investment managers and custodians and periodically to review those arrangements.'
- 1.3 The contents of this report and the procurement process demonstrate that this Committee is meeting both its regulatory and constitutional requirements.

2. ALTERNATIVE OPTIONS

- 2.1 An alternative to putting in place an equity risk management solution would be to reduce the physical allocation to equities and invest in another form of liquid growth asset. However, the potential problems with this are:
 - a. It could reduce the expected return to a degree that the Actuary is not comfortable with, which could undermine the funding policy. Equity risk management can give valuable downside protection without materially impacting the expected return.
 - b. If the Fund were to sell physical equities, a decision would need to be made about where to reinvest the assets. Assuming the Fund wanted to reinvest in liquid growth assets, there could be an argument that there are no obvious additional asset classes that currently look attractively valued and offer compelling return opportunities. The Fund Investment Consultant - Mercer believe there are some attractive return opportunities in private markets. However, it takes a long time (c.3/4 years) to get fully invested in these areas, which does not fit with the aim of protecting the funding position in view of the next formal actuarial valuation. However an equity risk management strategy could be implemented in a relatively straight-forward way and is highly flexible.

If there was a significant drop-off in equity markets before an equity risk management strategy could be implemented, this might impact the attractiveness of proceeding. This would be monitored in any case. Mercer has continued to see other clients implement this strategy so far this year – so the increase in equity market volatility hasn't had an overly detrimental impact to date.

3. DETAILS OF REPORT

- 3.1 The Committee delegated authority to the Chief Finance Officer S151 officer to investigate and procure equity protection manager at their March 2018 meeting.
- 3.2 Following a discussion with a Senior Legal Officer for the Council it was concluded that there is no need to conduct a full procurement under the OJEU regulations as this is a financial instrument which is exempt from the regulations. The appointment will involve moving assets into this mandate which will deliver the equity protection against a significant fall in the value of equities which would have a detrimental effect on the funding level of the Pension Fund.
- 3.3 The expected annual cost is £250k per annum. The mandate will be in place for 12 to 18 months until the triennial valuation has been conducted at which point it will be reviewed to ensure it meets the Fund's needs.
- 3.4 Mercer prepared and produced the necessary documentation in line with the requirements mentioned above and asked existing fund managers provide their proposals by 1st June. Goldman Sachs informed Mercer that they would not be responding to the proposal request because they had taken a commercial view that they would not be competitive on price. The remaining three managers submitted their proposal to Mercer for evaluation.
- 3.5 Mercer evaluated the submissions of the three managers and concluded that all the managers are credible and their pricing was competitive compared to what they have seen in recent years. After allowing for the fee schedule, the ranking of the submissions was as follows:
 1. Schroders
 2. Insight
 3. LGIM
- 3.6 All three managers were invited to present to a panel of officers to discuss their proposed solution. Following this the panel, in conjunction with Mercer and the Independent Adviser concluded that Schroders provided the optimum solution for the Fund's needs.
- 3.7 Given that the authority had been delegated to the CFO to seek and implement this solution, a report was submitted to the CFO and approval for the choice was given. This will now be put in place under the officer authority procedures.
- 3.8 Whilst this paper is for noting, Mercer will be in attendance at the Committee meeting in order to answer any questions about the solution that new members may have.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

- 4.1 This report provides an update on the procurement process for Equity Protection Manager Investment. The process was managed by officers and Fund Investment Advisers and costs associated with this have been met by the Pension Fund.

5. LEGAL COMMENTS

- 5.1 Under Local Government Pension Scheme Law the Council holds the pension funds as trustee to the benefit of the members of the scheme. Therefore, in all its actions the Council must act in a manner which is in the best interests of the scheme members. This appears to be the case as the Council has acted in a manner consistent with protecting the value of the fund.
- 5.2 The transaction which the Committee is asked to note relates to the “issue, sale, purchase or transfer of securities” as described under the exceptions to the application of the Public Contracts Regulations 2015. However, the Council is still required to undertake a reasonable level of investigation of the market place to which the services it requires relate. The Council has done this with the assistance of Mercer and therefore can be considered to have complied with its legal obligations in this regard.
- 5.3 The Committee is just asked to note the actions undertaken and therefore there are no other legal duties that need to be considered.
- 5.4 In any event it is unlikely that any considerations are required by the Committee as regards the Equality Act 2010 as this is a purely financial transaction

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 In the absence of a framework, to secure continuous improvement, the tender document were prepared to have regard to a combination of economy, efficiency and effectiveness (the best value duty). One principal way that the Council seeks to fulfil this duty generally is by subjecting spend to competition and choosing the winning bidder by applying pre-advertised evaluation criteria to ensure that the winning bid shows the best and appropriate mix of price and quality.

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 The rigorous robust management of LBTH Pension Fund results in better quicker and more effective decision making which can lead to better Fund performance and reduction in the contribution required from the Council towards the Fund.

9.2 The monitoring arrangement for the Pension Fund and the work of the Pensions Committee should ensure that the Fund optimises the use of its resources in achieving the best returns for the Council and members of the Fund.

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