



The London Borough of Tower  
Hamlets Pension Fund  
Investment Strategy Statement  
**Revised June 2019**

# **Investment Strategy Statement (Revised June 2019)**

## **1. Introduction and background**

- 1.1 This is the Investment Strategy Statement (“ISS”) of the Tower Hamlets Pension Fund (“the Fund”), which is administered by Tower Hamlets Council, (“the Administering Authority”). The ISS is made in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.
- 1.2 The Administering Authority has delegated all its functions as administering authority to the Pensions Committee (“the Committee”). The ISS, which was approved by the Committee on 29th November 2017, is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Committee has consulted on the contents of the Fund’s investment strategy with such persons it considers appropriate – for example, pensions board, independent adviser, local authority employers such as admitted bodies and scheduled bodies.
- 1.3 The Committee will invest in accordance with the ISS, any Fund money that is not needed immediately to make payments from the Fund.
- 1.4 The Pensions Committee is charged with the responsibility for the governance and stewardship of the Fund. The Fund has adopted a prudent, risk aware investment strategy, which is kept continually under review. Asset allocation decisions are taken in the best long term interest of Fund employers and member beneficiaries.
- 1.5 The ISS should be read in conjunction with the Fund’s Funding Strategy Statement, which sets out how solvency risks will be managed with regard to the underlying pension liabilities.

## **2.0 Long-term view of investments**

- 2.1 The Fund’s primary investment objective is to ensure that over the long term the Fund will have sufficient assets to meet all pension liabilities as they fall due. This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.
- 2.2 The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund’s assets and that an appropriate level of contributions is agreed by the employers to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary and/or inflation increases.
- 2.3 The strength of the respective employers’ covenant and the present cash flow positive nature of the Fund allow a long-term deficit recovery period and enable the Fund to take a long-term view of investment strategy.
- 2.4 The most important aspect of risk is not the volatility of returns, but the risk of absolute loss, and of not meeting the objective of facilitating low, stable contribution rates for employers. Illiquidity and volatility are risks which offer

potential sources of additional compensation to the long term investor. Although, it is more important to avoid being a forced seller in short term market setbacks.

- 2.5 Participation in economic growth is a major source of long term equity return. Over the long term, equities are expected to outperform other liquid assets, particularly government bonds and cash. Well governed companies that manage their business in a responsible manner will likely produce higher returns over the long term.
- 2.6 The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund. (See section 5.6) This benchmark is consistent with the Committee's views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities.
- 2.7 The Fund carried out an Asset Outperformance Assumption modelling exercise in conjunction with the 2016 actuarial valuation. The Committee set a target range of 66%-75% chance of achieving their long term funding target – returning to a fully funded position within the next 20 years. (The probability required for each employer to reach its funding target within its time horizon. In general, higher probabilities of success are achieved by paying higher contributions and relying less on volatile investment returns. The probability required for each employer is largely based on each employer's assessed covenant. For instance, a lower probability of success (e.g. 66%) may be required for a secure body as they may be considered to be able to pay higher contributions (or current rates for longer) should they not reach their funding target over their time horizon.
- 2.8 This approach helps to ensure that the investment strategy takes due account of the maturity profile of the Fund (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the funding bases used).
- 2.9 In line with the above overall objective the Fund will invest money in a wide variety of investments, having assessed the suitability of particular investments; the investment objectives, the impact of different economic scenarios on achieving required total Fund returns, and the resulting diversity across the whole Fund. Prior to any such decisions being made the Fund will take appropriate external independent advice.
- 2.10 The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation. The Fund will invest in accordance with its investment strategy, any Fund money that is not needed immediately to make payments from the Fund. Any deviations within guidelines from the agreed strategy will be reported to the Pensions Committee, the Pensions Board and the Section 151 Officer so that appropriate corrective actions can be undertaken.

### **3.0 The investment objectives of the Fund**

- a) The long-term objective is for the Fund to achieve a funding level of 100% over a maximum fund recovery period of 20 years from April 2016. This

target will be reviewed following each triennial actuarial valuation and consultation with Fund employers.

- b) The outcome of the last valuation carried out as at 31st March 2016:
- The funding level has improved from 71.8% to 82.7%.
  - In monetary terms the deficit has reduced by £130m from £365m (at March 2013) to £235m (March 2016). This was based on the Fund having assets of £1,126m and liabilities of £1,361m.
- c) The actuarial valuation, at 31 March 2016, was prepared on the basis of an expected real return on assets of 2% over the long term, a nominal return of 4.2% assuming inflation (CPI) to be 2.2%.
- d) The Fund's objective is to perform in line with this target over 10 years, by investing in a diversified portfolio of return-generating assets.
- e) In order to monitor the investment objective, the Pensions Committee requires the provision of detailed performance measurement of the Fund's investments. This is provided by the Fund's custodian, State Street, on a quarterly basis. In addition, the Pensions Committee conducts a formal annual performance review of each of its investment managers.
- f) The actuarial funding target is reviewed after periodic actuarial valuations and consultation with Fund employers and may undergo a partial or full review at other times should circumstances warrant it.

#### **4. Strategy Review and Strategic Benchmark**

- 4.1 A full Strategic Investment Review will be undertaken by the Fund every three to six years by specialist professional advisors. The investment strategy (including the core investment objectives and asset allocations) will be sufficiently flexible to meet longer term prevailing market conditions and address any short term cash flow requirements. Interim reviews may be undertaken to ensure that the Strategy remains appropriate.
- 4.2 The Fund will operate a fund-specific benchmark for the investment portfolio, with long-term allocations to the various investment asset classes, which reflect the circumstances of the Fund.
- 4.3 As is appropriate all asset classes and products will be kept under continual review. In addition to considering the benefits of individual products and asset classes for introduction into the strategy, consideration will be given to how the inclusion affects the overall risk/return characteristics of the total portfolio. Before any investment decisions are made by the Pensions Committee, professional advice will be sought. If there are any instances where advice received is not to be acted upon reporting to both the Committee and the Pensions Board will ensue.

#### *Asset classes*

- 4.4 The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, cash, property, infrastructure and commodities either directly or through pooled funds. The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products for the purpose of efficient portfolio management or to hedge specific risks.
- 4.5 The Committee reviews the nature of Fund investments on a regular basis, with particular reference to suitability and diversification. The Committee seeks and considers written advice from a suitably qualified person in undertaking such a review. If, at any time, investment in a security or product not previously known to the Committee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.
- 4.6 The Fund's target investment strategy is set out below. The table also includes the maximum percentage of total Fund value that it will invest in these asset classes. In line with the Regulations, the authority's investment strategy does not permit more than 5% of the total value of all investments of Fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007.
- 4.7 The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation, s151 officer and her officers have the delegated authority to rebalance the Fund to its strategic asset allocation.

<b>Asset class</b>	<b>Targeted Strategic Asset Allocation %</b>	<b>Investments Range (%)</b>
Global equities	50%	(45% - 55%)
<b>Total equities</b>	<b>50%</b>	<b>(45% - 55%)</b>
Property	12%	(10% - 15%)
Diversified Growth Funds	20%	(15% - 25%)
Absolute Return Bonds	12%	(10% - 15%)
Index Linked Gilts	6%	(3% - 9%)
<b>Total</b>	<b>100%</b>	<b>100%</b>

#### *5. Restrictions on investment*

- 5.1 The Regulations do not permit more than 5% of the Fund's value to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007(e). The investment policy of the Fund does not permit any employer-related investment, other than is necessary to meet the regulatory requirements with regards to pooling.

- 5.2 The Pensions Committee believes that the Fund's portfolio is adequately diversified, and has taken professional advice to this effect from their investment consultant and independent advisor.
- 5.3 The strategic asset allocation includes ranges for each asset class within which the asset allocation can vary. In the event that any asset class range is breached, the Pensions Committee will be informed and the Fund's officers will endeavour to bring the asset allocation back within the range within an appropriate period of time.
- 5.4 The Pensions Committee reviews the suitability of the asset allocation of the Fund on a yearly basis, following advice from the officers, investment consultant and independent advisor.
- 5.5 It is intended that the Fund's investment strategy will be reviewed at least every three years, following the latest actuarial valuation of the Fund. The investment strategy takes due account of the maturity profile of the Fund and the current funding position.
- 5.6 The Pensions Committee has set the following benchmark against which performance of the Fund will be measured:

<b>Asset class</b>	<b>Benchmark</b>
<b>Equities</b>	
Passive Global Equity	FTSE All World Equity Index
Passive Global Equity Hedged	FTSE All World Equity Index GBP Hedged
Passive Global Equity Low Carbon Hedged	MSCI World Low Carbon Target Index GBP Hedged
Active Global Equity	MSCI AC World Index
<b>Bonds and Cash</b>	
UK Index Linked Gilts Over 5 Years	FTSE UK Gilts Index-Linked Over 5 Years Index
Absolute Return Bonds (Insight)	3 Months LIBOR plus 3%
Absolute Return Bonds (GSAM)	3 Months LIBOR plus 4%
Cash	LIBID 7 Day
<b>Alternatives</b>	
Property Unit Trusts	UK IPD Monthly Index Property
Diversified Growth Funds	3 Months LIBOR plus 3%

## 6.0 Managers

- 6.1 The Committee has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.
- 6.2 The Committee, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate, they are consistent with the overall asset allocation for the Fund.
- 6.3 The Fund's investment managers will hold a mix of investments which reflect their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles.
- 6.4 The manager of the passive funds in which the Fund invests holds a mix of investments within each pooled fund that reflects their respective benchmark indices as set out in section 5.6.
- 6.5 The Fund's current structure and performance targets are set out in the table below.

<b>Current Managers and Mandates</b>				
<b>Manager</b>	<b>Mandate</b>	<b>Benchmark Allocation</b>	<b>Investment Ranges</b>	<b>Performance Target</b>
LCIV (Baillie Gifford)	Global Equities (Active & Growth)	20%	15%-25%	Outperform benchmark by 2-3% over a rolling 3 year period
	Diversified Growth	10%	7.5%-12.5%	3 Months LIBOR +3% per annum
LCIV (Ruffer)	Diversified Growth	10%	7.5%-12.5%	3 Months LIBOR +3% per annum
Goldman Sachs	Pooled Bonds (Absolute Return)	3%	2%-4%	3 Months LIBOR +4% per annum
Insight	Pooled Bonds (Absolute Return)	3%	2%-4%	3 Months LIBOR +3% per annum
LCIV MAC (CQS)	Multi Asset Credit	6%	4%-8%	3 Months LIBOR +4% per annum

Legal & General	UK Index Linked (Passive)	6%	3%-9%	FTSE A Gov Index Linked >5yrs
	Global Equities (Passive)	15%	12%-18%	33% FTSE All World Equity Index, 67% FTSE All World Equity Index GBP Hedged
	Global Equities (Passive Low Carbon)	15%	12%-18%	MSCI World Low Carbon Target Index GBP Hedged
Schroders	Property	12%	10%-15%	Outperform benchmark by 0.75% over a rolling 3 year period

## 7. The approach to risk

7.1 The Committee is aware that the Fund has a need to take risk (e.g. investing in growth assets) to help it achieve its funding objectives. It has a programme in place that aims to help it identify the risks being taken and put in place processes to manage, measure, monitor and (where possible) mitigate the risks being taken.

7.2 The principal risks affecting the Fund and the Fund's approach to managing these risks and the contingency plans that are in place are set below:

### *Funding risks*

- Financial mismatch – The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.
- Changing demographics –The risk that longevity improves and other demographic factors change, increasing the cost of Fund benefits.
- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Fund's liabilities. (The impacts is reducing the value of investments/assets and requiring increased employer's contributions).

7.3 The Committee measures and manages financial mismatch in two ways. As indicated above, the Committee has set a strategic asset allocation benchmark for the Fund. This benchmark was set taking into account asset liability modelling which focused on probability of success and level of downside risk.

7.4 The Committee assesses risk relative to the strategic benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. The Committee also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

7.5 The Committee also seeks to understand the assumptions used in any analysis and modelling so they can be compared to their own views and the level of risks associated with these assumptions to be assessed.

7.6 The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

#### 7.7 *Asset risks*

- Concentration - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Fund’s assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Environmental, social and governance (“ESG”) – The risk that ESG related factors reduce the Fund’s ability to generate the long-term returns.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

7.8 The Committee measure and manage asset risks as follows:

- a) The Fund’s strategic asset allocation benchmark invests in a diversified range of asset classes. The Committee has delegated rebalancing arrangements to s151 officer and her officers to ensure the Fund’s “actual allocation” does not deviate from its maximum limits. The Fund invests in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, help reduce the Fund’s asset concentration risk. By investing across a range of assets, including liquid quoted equities and bonds, as well as property; the Committee has recognised the need for access to liquidity in the short term.
- b) The Fund invests in a range of overseas markets which provides a diversified approach to currency markets; in addition, the Committee has agreed to hedge 50% of the overseas currency exposure relating to the global equity allocation. This is achieved by investing in pooled currency hedged funds managed by LGIM. Detail of the Fund’s approach to managing ESG risks is set out later in this document.
- c) The Committee has considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by appointing more than one manager and having a proportion of the Scheme’s assets managed on a passive basis. The Committee assess the Fund’s managers’ performance on a regular basis, and will take steps, including potentially replacing one or more of their managers, if underperformance persists.

### 7.9 *Other provider risk*

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee seeks suitable professional advice.
- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.

7.10 The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Fund, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). The Committee has the power to replace a provider should serious concerns exist.

7.11 A more comprehensive breakdown of the risks to which the Fund is exposed and the approach to managing these risks is set out in the Fund's risk register and policy documents.

## 8. **Pooling of investments**

8.1 The Fund is a participating scheme in the London Collective Investment Vehicle (LCIV) Pool. The proposed structure and basis on which the LCIV Pool will operate was set out in the July 2016 submission to Government.

8.2 The London CIV has been operational for some time and is in the process of opening a range of sub-funds covering liquid asset classes, with less liquid asset classes to follow.

8.3 The Fund has already transitioned assets into the London CIV with current allocation of 52% of total assets, and will look to transition further liquid assets as and when there are suitable investment strategies available on the platform that meet the needs of the Fund.

8.4 The Fund has a target allocation of 36% in life funds and these are outside of the London CIV in accordance with government guidance on the retention of life funds outside pools for the time being.

- 8.5 The Fund is monitoring developments and the opening of investment strategy funds on the London CIV platform with a view to transitioning liquid assets across to the London CIV as soon as there are suitable sub-funds to meet the Fund's investment strategy/ asset allocation requirements.
- 8.6 Any assets not currently invested in the Pool will be reviewed at least annually to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money.

### **Structure and governance of the LCIV Pool**

- 8.7 The July 2016 submission to Government of the LCIV Pool provided a statement addressing the structure and governance of the Pool, the mechanisms by which the Fund can hold the Pool to account and the services that will be shared or jointly procured.
- 8.8 The below diagrams sets out the governance structure for the London CIV. The governance structure of the CIV has been designed to ensure that there are both formal and informal routes to engage with all the Authorities as both shareholders and investors. This is achieved through a combination of the London Councils' Sectoral Joint Committee, comprising nominated Member representatives from the London Local Authorities (in most cases the Pensions Committee Chair), and the Investment Advisory Committee ("IAC") formed from nominated borough officers, which includes both London Local Authority Treasurers and Pension Officers from a number of Authorities.
- 8.9 As an AIFM, London CIV must comply with the Alternative Investment Manager Directive ("AIFMD") and falls under the regulatory scrutiny and reporting regime of the Financial Conduct Authority ("FCA"). This includes the requirement for robust systems and processes and for these to be documented appropriately in policies and manuals. Risk management is a particular focus for the FCA and London CIV has developed a risk framework and risk register covering all areas of its operations, including fund management.
- 8.10 The Pensions Sectoral Joint Committee ("PSJC") has been established under the governing arrangements of London Councils. The PSJC effectively fulfils two roles, one is as a mechanism for convening elected Member representation from each borough (generally the borough's Pension Committee Chair), and the other is as the route to convening the Authorities as shareholders in London CIV. This Committee will provide scrutiny and oversight of the CIV for the Authorities, with each Borough represented on the Committee with voting rights.
- 8.11 Borough Pension Committees – In most instances the Chair of the Pensions Committee at a Borough level will be the delegated representative on the PSJC and will be able to provide an overview back to the individual Committee on the work of the London CIV and its effectiveness from attending the PSJC. In addition the London CIV will provide regular updates to Authorities through its written reports and will also attend Committee meetings as and when required and in this way will help to ensure that the individual Pensions Committee are able to provide scrutiny of the London CIV.

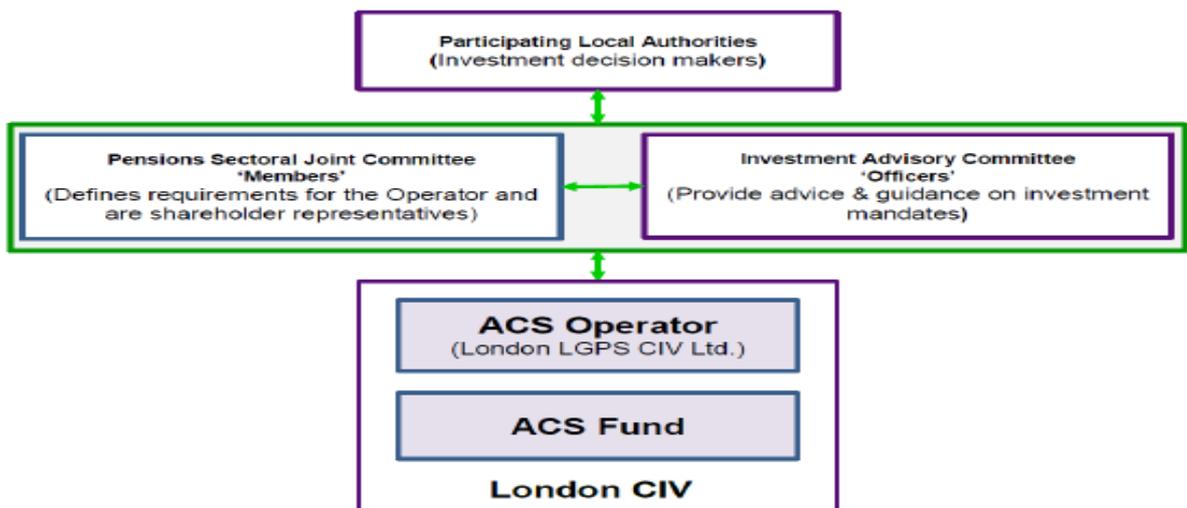
8.12 The Investment Advisory Committee (IAC) was formed in September 2015 with the remit to:

- To support the Joint Committee in the investment decision making process
- To liaise with the Fund Operator of the CIV in defining Shareholders' investment needs.

8.13 Membership of the IAC was renewed in July 2016 with London Treasurers being asked to nominate themselves and or their officers, 24 nominations were received. Whilst this was greater than allowed for under the Terms of Reference, after consideration, it was agreed that the full complement of nominations should be included in the Committee.

8.14 This was to ensure at a time of rapid development for the London CIV, as many Pension Funds could be engaged fully in the process and that this would also enable a wide range of pension managers to work closely alongside officers of the CIV. The new Committee comprised 9 London Treasurers and 15 Pension Managers.

### LONDON CIV GOVERNANCE STRUCTURE



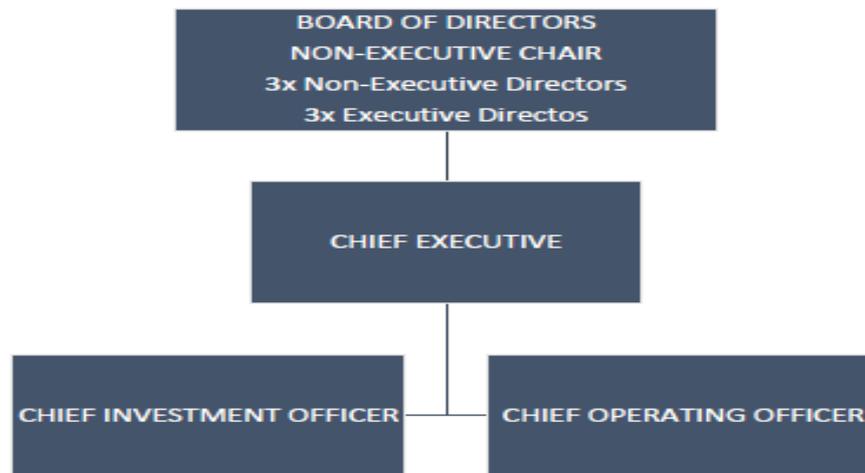
8.15 At the company level for London CIV, it is the Board of Directors that is responsible for decision making within the company, which will include the decisions to appoint and remove investment managers. The Board of the CIV has ultimate responsibility for all aspects of management of the Company. The board will at all times retain and exercise overall control. As a result the board composition seeks to achieve a balance of skills, competencies and expertise to govern on behalf of the shareholders.

8.16 The board will challenge the business, has a strong focus on oversight of both the organisation and third parties, and understands its duties as a regulated Company. The board have a mix of relevant investment, operational and financial experience having held senior roles at regulated entities combined with a strong understanding of local government and the requirements of its

shareholders. The governance practices will be commensurate with the business and nature of the investment funds it manages.

8.17 The board is comprised of seven members both executive and non-executive with a range of skills. The non-executive directors are independent third parties with experience gained from either local government or careers in financial services and each have in-depth understanding of their respective fields. The executive team are responsible for the day-to-day operations of the business and setting the strategic direction of the Company. The non-executive directors will provide independent judgment and challenge to the board based on their respective experience.

### LONDON CIV BOARD - COMPANY STRUCTURE



### **Performance measurement**

8.18 Fund performance is measured at a number of different levels. The objective of the Fund is to outperform the actuarial discount rate. The policy portfolio is selected by the Committee, with advice from the Fund Investment Advisers and Officers, and investment managers including LCIV, is expected to generate returns above the discount rate.

8.19 The performance of the pooling arrangements is monitored via regular reporting and through periodic meetings. Performance for LCIV is measured against the policy portfolio. LCIV seeks to outperform the policy portfolio on a risk adjusted basis, via active sub-funds creation/selection and or selecting the best managers for each of the sub-funds and by implementing investments in a low cost manner. Performance for the investment sub-funds is measured against widely used and transparent benchmarks.

8.20 Where performance falls short of expectations the Committee, Officers and the Investment Advisers for the Fund will identify the cause of this underperformance and will respond appropriately either to alter its policy portfolio (where asset allocation is the underlying cause) or to require changes to the management of the sub fund vehicles (where management skill within LCIV is the underlying cause).

## 9. Social, Environmental and Corporate Governance

9.1 It is recognised that ESG factors can influence long term investment performance and the ability to achieve long term sustainable returns. The Committee consider the Fund's approach to responsible investment in two key areas:

- *Sustainable investment / ESG factors* – considering the financial impact of environmental, social and governance (ESG) factors on its investments.
- *Stewardship and governance* – acting as responsible and active investors/owners, through considered voting of shares, and engaging with investee company management as part of the investment process.

### **Sustainable investment / ESG**

9.2 The Fund is committed to being a long term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. In addition the Pensions Committee undertakes training on a regular basis and this will include training on and information sessions on matters of social, environmental and corporate governance.

9.3 The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It expects its managers to follow good practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed.

9.4 The Fund expects its external investment managers (and specifically the London Collective Investment Vehicle through which the Fund will increasingly invest) to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the fund such as corporate governance and environmental factors. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making.

9.5 Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes. The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

9.6 The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors where these present financial risks to the delivery of portfolio objectives and therefore impact on the sustainability of the Fund's returns.

- 9.7 Where appropriate, the Committee considers how it wishes to approach specific ESG factors in the context of its role in asset allocation and investment strategy setting. The Committee considers exposure to carbon risk in the context of its role in asset allocation and investment strategy setting. The exposure that the Fund has to fossil fuels is largely through investments in equity portfolios which aim to outperform, or track the performance of, broad market indices which themselves include allocations to companies that are responsible for carbon emissions.
- 9.8 Taking into account the ratification in October 2016 of the Paris Agreement, the Committee considers that significant exposure to fossil fuel reserves within the Fund's portfolio could pose a material financial risk. In summer 2018, a Carbon Risk Audit for the Fund was carried out, quantifying the Fund's exposure through its equity portfolio to fossil fuel reserves and power generation and where the greatest risks lie.
- 9.9 Having taken into account the risks associated with exposure to fossil fuel reserves, the Committee has approved a target to:
- For overall Equity portfolio to be 60% lower in carbon exposure relative to the MSCI ACWI benchmark in 5 years and or;
  - Reduce the Fund's relative exposure to future emissions from fossil fuel reserves (measured in MtCO<sub>2</sub>e – million tonnes of CO<sub>2</sub> emissions) by 50% over 2 valuation cycles; and
  - Measure the reduction relative to the Fund's position as at March 2018 (which was 122tCO<sub>2</sub>e relative to the MSCI ACWI benchmark of 195tCO<sub>2</sub>e) and adjusted for Assets under Management (£AUM).
- 9.10 This will be periodically reviewed to ensure that it remains consistent with the risks associated with investment in carbon assets and with the Committee's fiduciary duties.
- 9.11 Where necessary, the Fund will also engage with its Investment Managers and or the London CIV to address specific areas of carbon risk. The Fund expects its investment managers to integrate financially material ESG factors into their investment analysis and decision making and may engage with managers and the London CIV to ensure that the strategies it invests in remain appropriate for its needs. However, the Fund does not at this time operate a blanket exclusion policy in respect of specific sectors or companies.
- 9.12 At the present time the Committee does not take into account non-financial factors when selecting, retaining, or realising its investments. The Committee reviews its approach to nonfinancial factors periodically, taking into account relevant legislation and the Law Commission's guidance on when such factors may be considered. Additionally, the Committee monitors legislative and other developments with regards to this subject and will review its approach in the event of material changes.
- 9.13 The Fund does not exclude investments in order to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than

where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

- 9.14 The Fund does not at the time of preparing this statement hold any assets which it deems to be social investments; however, this ISS places no specific restrictions on the Fund in respect of such investments beyond those of suitability within the Investment Strategy as a whole and compatibility with the Committee's fiduciary duties. In considering any such investment in the future, the Committee will have regard to the Guidance issued by the Secretary of State and to the Law Commission's guidance on financial and non-financial factors.
- 9.15 The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

### **Voting rights**

- 9.16 The Fund recognises the importance of its role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Fund recognises that ultimately this protects the financial interests of the Fund and its ultimate beneficiaries.
- 9.17 The Fund has a commitment to actively exercising the ownership rights attached to its investments reflecting the Fund's conviction that responsible asset owners should maintain oversight of the companies in which it ultimately invests recognising that the companies' activities impact upon not only their customers and clients, but more widely upon their employees and other stakeholders and also wider society.
- 9.18 The Committee has delegated the exercise of voting rights to the investment manager(s) on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The managers are strongly encouraged to vote in line with voting alerts issued by the Local Authority Pension Fund Forum (LAPFF) as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2) (f). The Committee has elected to monitor the voting decisions made by all its investment managers on a regular basis.
- 9.19 The Fund's investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the Pensions Sectoral Joint Committee. Voting is delegated to the external managers and monitored on a quarterly basis. The CIV will arrange for managers to vote in accordance with voting alerts issued by the Local Authority Pension Fund Forum (LAPFF) as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions.
- 9.20 The Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the Council / Pension Fund website.

## **Stewardship**

- 9.21 The Fund complies with the UK Stewardship Code ('the Code') and is preparing a formal statement of commitment with the Code for assessment. The current draft is set out in Appendix A.
- 9.22 The Fund expects its external investment managers to be signatories of the Stewardship Code and reach Tier One level of compliance or to be seeking to achieve a Tier One status within a reasonable timeframe. Where this is not feasible the Fund expects a detailed explanation as to why it will not be able to achieve this level.
- 9.23 In addition, the Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly.
- 9.24 The Committee recognises that taking a collaborative approach with other investors can help to achieve wider and more effective outcomes.  
The Fund:
- (a) is a member of the Local Authority Pension Fund Forum (LAPFF) and in this way joins with other LGPS Funds to magnify its voice and maximise the influence of investors as asset owners;
  - (b) is a member of the Pension and Lifetime Savings Association (PLSA) and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners;
  - (c) gives support to shareholder resolutions where these reflect concerns which are shared and represent the Fund interest; and
  - (d) joins wider lobbying activities where appropriate opportunities arise.

## **Myners principles for investment decision making**

- 9.25 The old regulation requiring administering authorities to state the extent to which they comply with Myners principles for investment decision making no longer applies. However, they should still have regard to the guidance. This section has been kept in this document as Appendix B for Tower Hamlets Funds, with some small amendments to keep the responses current.

## **Full compliance**

The Fund's annual report includes all of the Fund's policies including the governance policy statement, governance policy compliance statement, communications policy statement, responsible investment and stewardship policy, funding strategy statement and statement of investment principles. The annual report can be found on the council's website.

Quarterly reports to the Pensions Committee and Pensions Board on the management of the Fund's investments are publicly available on the council's website. <http://democracy.towerhamlets.gov.uk/mgCommitteeDetails.aspx?ID=392>

Prepared by: - Bola Tobun (Investment & Treasury Manager)  
(For and on behalf of LBTH Pensions Committee)

## **Appendices**

Appendix A – Draft Statement of Commitment with the UK Stewardship code

Appendix B – Myners Investment Principles – Compliance Statement

## **Appendix A - Draft Statement of Commitment with the UK Stewardship Code**

### **Principle 1: *Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.***

The Fund takes its responsibilities as a shareholder seriously and has made a commitment to the informed exercise of its ownership rights as detailed in the Fund's Investment Strategy Statement.

The Fund invests via pooled funds and therefore expects its underlying investment managers to exercise voting and engagement rights on its behalf. The Fund encourages its underlying investment managers to comply with the UK Stewardship Code.

The Fund is subject to the ESG and voting policies of its underlying investment managers. The Pensions Committee ('the Committee') considers these policies when appointing a new manager and when monitoring investment managers, the Fund's Officers consider whether each manager's actions and engagement activities have been appropriate and in keeping with the Fund's policy.

In considering its stewardship activities, the Fund monitors the activities of its investment managers with regard to the following:

- The exercise of voting rights
- The integration and management of Environmental, Social and Corporate Governance (ESG) issues
- Engagement activities and progress

The Fund is a long-term investor and is committed to being an active owner. It wishes to promote a policy of dialogue on responsible investment issues, through its investment managers, with company management.

The Committee has identified the following ESG issues as a focus for engagement:

- Environmental issues: including conserving energy, promoting alternative energy sources, recycling, avoiding pollution and using environmentally friendly and sustainable resources
- Human rights: including child labour issues in foreign subsidiaries of UK companies or operations in countries with oppressive regimes
- Employment standards: including equal opportunities, health and safety, trade union recognition and employee participation

The Fund recognises that taking a collaborative approach with other investors can help to achieve wider and more effective outcomes and is a member of the Local Authority Pension Fund Forum (LAPFF), which aims to promote best practice on corporate governance and RI issues through co-operative action with other local authority funds.

The Fund regularly reviews its approach to responsible investment and the exercise of its stewardship activities.

**Principle 2: *Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.***

The Fund expects its investment managers to have effective policies addressing potential conflicts of interest related to stewardship.

In respect of potential conflicts of interest within the Fund, the Committee members are required to make declarations of interest prior to panel meetings.

All declarations are captured in the minutes of the meeting, which are publicly available, potential conflicts, based on declarations, are managed accordingly by the Chair of the Committee.

**Principle 3: *Institutional investors should monitor their investee companies.***

While the day-to-day responsibility for managing the Fund's equity holdings is delegated to the Fund's appointed investment managers, the Fund recognises that it cannot delegate its stewardship obligations. The Fund's Committee and Officers monitor the Fund's investment managers on a regular and ongoing basis, including with respect to stewardship activities.

As such the Fund expects its investment managers to monitor investee companies, intervene where necessary, and report back regularly on activity undertaken. This may be via written reports, phone calls, or meetings with the Officers and the Committee.

In addition, the Committee receives an annual report from the Fund's investment consultant on the ESG credentials, including active ownership, of its investment managers.

**Principle 4: *Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.***

Responsibility for day-to-day interaction with companies is delegated to the Fund's investment managers, including the escalation of engagement when necessary.

The Fund's Officers and Committee monitor the escalation activities undertaken by the Fund's investment managers through the regular reporting provided by the Fund's managers.

On occasion, the Fund may itself choose to escalate activity; this will typically be through its membership of LAPFF or via one of the underlying investment managers.

Escalation activities undertaken by LAPFF may include writing a letter to the board or additional meetings with company management.

**Principle 5: *Institutional investors should be willing to act collectively with other investors where appropriate.***

The Fund seeks to work collaboratively with other institutional shareholders in order to maximise the influence that it can have on individual companies.

The Fund undertakes collective engagement activities through its membership of LAPFF as well as through initiatives proposed by the Fund's investment managers or advisors.

In addition, the fund has formally agreed to join the London Collective Investment Vehicle (CIV) and regularly collaborates with other members of the CIV with respect to ESG and stewardship issues.

**Principle 6: *Institutional investors should have a clear policy on voting and disclosure of voting activity.***

The Fund invests via pooled funds and is therefore subject to the underlying investment managers' policies. The Fund expects its investment managers to exercise all votes associated with the Fund's equity holdings where practicable. The Fund encourages its investment managers to publicly disclose their voting records.

Generally, the Fund expects its investment managers to support resolutions that are consistent with the UK Corporate Governance Code and represent best practice. In overseas markets, the Committee expects the managers to take account of local best practice principles.

Where resolutions or issues fall short of the expected standards, the Committee expects managers will either abstain or vote against, depending on the individual circumstances of the company and the issues presented. The Committee expects the investment managers to report on their voting activities on a regular basis and the Fund's Officers consider whether each manager's actions and engagement activities have been appropriate and in keeping with the Fund's policy.

The policy is reviewed at least annually in order to take account of regulatory developments and timely or controversial issues may be discussed at Committee meetings.

**Principle 7: *Institutional investors should report periodically on their stewardship and voting activities.***

The Fund expects its underlying investment managers to report regularly to both the Officers and the Committee with respect to voting and engagement activities, including examples of company engagement, progress on engagement over time and collaborative activities. The Fund encourages its investment managers to publicly report on their stewardship activities.

The Fund will report on its stewardship activity to the Committee on an annual basis. In addition, quarterly reports of voting actions are posted as part of the

funds reporting to Committee and are available on the Council's website:

<http://democracy.towerhamlets.gov.uk/ieListMeetings.aspx?CommitteeId=392>

The Committee will provide an annual report on how the Fund satisfies its UK Stewardship Code obligations requirements, which will be made available publicly.

This statement has been approved by the Committee on 16 March 2017.

### **Compliance and monitoring**

The investment managers are required to adhere to the principles set out in this Investment Strategy Statement. The Pensions Committee will require an annual written statement from the investment managers that they have adhered to the principles set out in this statement.

If you have any questions on this statement or the Fund's approach to stewardship, please contact Bola Tobun, Investments and Treasury Manager by e-mail at the following address [Bola.Tobun@towerhamlets.gov.uk](mailto:Bola.Tobun@towerhamlets.gov.uk)

## **Appendix B - Myners Investment Principles – Compliance Statement**

### **Principle 1: Effective Decision-making**

Administering authorities should ensure that:

- decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and
- those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

#### **Full compliance**

The Pensions Committee and Pensions Board are supported in their decision making/assisting roles by the Corporate Director, Resources and the Investment and Treasury Manager.

Members of the both Committee and Board participate in regular training delivered through a formal programme. Training is provided at every quarterly meeting.

### **Principle 2: Clear Objectives**

An overall investment objective should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local taxpayers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisors and investment managers.

#### **Full compliance**

The Fund's overall objectives are defined in the Funding Strategy Statement and are directly linked to the triennial actuarial valuation. The investment objectives are clearly stated in the Statement of Investment Principles/Investment Strategy Statement.

The content of the Funding Strategy Statement reflects discussions held with individual scheme employers during the actuarial valuation process. Employers understand that contribution rates are set, having given consideration to the key tenets of affordability, sustainability and stability but also with the understanding that any decisions made must be prudent. To this end, the strength of the employer covenant is considered when setting contribution rates.

### **Principle 3: Risk and liabilities**

In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities. These include the implications for the local taxpayers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

#### **Full compliance**

The Fund's actuary reviews the funding position of each employer every three years and this valuation includes an assessment of the gap between the employer's share of the Fund assets and the liabilities specific to each employer. The strength of the employer covenant is considered when setting contribution rates.

The Fund's investment strategy is reviewed following each triennial valuation to ensure that the investment strategy will achieve the expected returns assumed during the valuation process.

As a member of Club Vita, a bespoke set of assumptions are specifically tailored to fit the membership profile of the Tower Hamlets Fund. The assumptions selected are intended to make an appropriate allowance for future improvements in longevity, based on the actual experience of the Fund.

#### **Principle 4: Performance assessment**

Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.

Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.

#### **Full compliance**

Each manager's performance is measured quarterly against benchmark targets, which are specified in the contract between the Fund and the manager. The Fund's global custodian produces performance data for each manager and for the Fund as a whole. The target outperformance for the Fund as a whole is specified within the Statement of Investment Principles/Investment Strategy Statement. The Fund performance is also assessed with reference to the local authority peer group.

Performance data is reported to the Committee on a quarterly basis. Fund managers present to the officers or the Committee on at least an annual basis and officers hold four additional meetings with managers per quarter to discuss the portfolio composition, strategy and performance.

Consideration has been given to quantitative measures to assess the performance of the Committee, although options other than measuring meeting attendance and the success of the Committee's implemented strategies are limited.

#### **Principle 5: Responsible ownership**

Administering authorities should:

- Adopt, or ensure their investment managers adopt, the Stewardship Code.
- Include a statement of their policy on responsible ownership in the statement of investment principles.

- Report periodically to scheme members on the discharge of such responsibilities.

### **Full compliance**

All new investment mandates will be expected to include a statement of a manager's adoption of the Stewardship Code.

The Council wishes to have an active influence on issues of environmental or ethical concern with companies in which the Pension Fund is a shareholder. It will seek to codify its approach with Fund Managers and will use the services of specialist agencies as necessary to identify issues of concern.

The Council requires the Fund Managers to take into account the implications of substantial "extra financial" considerations, e.g., environmental, social or reputational issues that could bring a particular investment decision into the public arena.

The Fund wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles. In addition, the Fund is a member of the Local Authority Pension Fund Forum (LAPFF), thus demonstrating a commitment to sustainable investment and the promotion of high standards of corporate governance and responsibility.

All of the Fund's managers are signed up to the Stewardship Code, which provides a framework for investors to consider environmental, social and corporate governance issues when making investment decisions.

### **Principle 6: Transparency and reporting**

Administering authorities should:

- Act in a transparent manner, communicating with stakeholders on issues relating to their management of investments, its governance and risks, including performance against stated objectives
- Provide regular communication to scheme members in the form they consider most appropriate