APPENDIX

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London Borough of Haringey Pension Fund
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Pension Fund Governance Arrangements

Introduction

At the Pension Committee meeting on 18 September 2008, several Committee members expressed a desire to review the structure of the Committee meetings. With so many moving parts, and the limited time of Elected Members, having a good governance structure is critical to making effective and timely decisions and to helping to achieve the ultimate objective of funding the Fund at reasonable cost to the Employers.

As the new investment advisers to the Fund, we have been asked to review the governance arrangements and we propose a number of possible alternatives that could work in a more effective and efficient manner.

Increasing demands on 'Trustees'

With many pension funds in deficit and funding levels failing to improve despite substantial contributions from employers, the investment decisions taken are more critical than ever.

Elected Members and Officers are under enormous pressure in the face of rapidly evolving markets and a continually changing landscape of investment risks and opportunities. Bombarded by new and often complex products and instruments from fund managers and investment banks, funds are striving to strike a balance between long-term strategy and short-term investment volatility.

In many cases these funds are hampered by slow decision-making processes; strategies run the risk of being driven by fixed timetables, meeting agendas and Elected Member availability rather than investment criteria. As a result, funds may be in danger of settling for a sub-optimal investment strategy.

LGPS regulations

The Local Government Pension Scheme (LGPS) is one of the largest public sector pension schemes in the UK. The Scheme is administered locally for participating employers through regional funds. The vast majority of these funds are administered by local councils. These 'administering authorities' are responsible for collecting contributions and paying pensions, maintaining the records of scheme members and the investment arrangements of the scheme.

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LGPS regulations (continued)

The regulations which govern the investment arrangements of the funds are the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended). Sections 7 and 8 of the Regulations set out the legal responsibilities with regard to terms of appointment and the review of an investment manager's performance. Relevant points are:

- The investment manager must report to the administering authority at least once every three months on the action he has taken for them.
- Where an administering authority have appointed an investment manager they must keep his performance under review.
- At least once every three months they must review the investments he has made.
- Periodically they must consider whether or not to retain him.
- In reviewing an investment manager's decisions and appointment, an administering authority must take proper advice.

Industry Best Practice

The LGPS regulations are very general and do not dictate how pension funds should be managed. In 2001, Paul Myners completed his industry wide review of pension funds and published the Myners Code of Best Practice for pension funds. It is voluntary code covering ten aspects of pension scheme governance.

CIPFA specifically adopted these ten Principles of Investment for LGPS schemes in April 2002, and in August 2002 the LGPS Investment Regulations were amended so that Administering Authorities had to '...state the extent to which the administering authority compl[ies] with the ten principles of investment practice.' These are included for reference in the Appendix.

Current Governance Arrangements

As we understand it, the current governance arrangements of the London Borough of Haringey Pension Fund are as follows:

- A Pensions Committee has been created by the Council to oversee its responsibilities as the administering authority for the Haringey Pension Fund.
- The Committee is comprised of 7 Elected Members and is chaired by Cllr Gmmh Rahman Khan.
- The Committee also has a number of non-Elected Members who participate in meetings. These include the independent advisor Howard Jones and some non-voting representatives of scheme members.
- The Committee normally meets 6 times a year; 4 are meetings with Fund Managers present and 2 are not.
- In addition to broader pension fund business, at each meeting the Committee also receives 10 minute presentations from some of the Fund's investment managers, with 15 minutes set aside for questions.
- The Officers and independent adviser also meets with the Fund's managers on a quarterly basis (Private Equity and Currency on a semi-annual basis) to review performance.

Current Governance Arrangements (continued)

- Officers are responsible for the 'administration' of the Fund's investment arrangements.
- Procurement of services for the Pension Fund is carried out via the public tendering process overseen by Council staff.

Our initial thoughts on the current arrangements

There are some good points regarding the current arrangements:

- The Elected Members regularly see the Fund's investment managers and have the opportunity to question them.
- Meetings are held frequently and as a result a significant amount of time is spent on pension fund matters.
- Elected Members, Advisers and Officers have a regular opportunity to work closely together, thereby building up trust and co-operation.

However, there are also some potential issues with the current arrangements:

- Although we have very limited experience of the Fund, the meeting agendas do not appear to us to allow the Members sufficient time to concentrate on strategic matters. In the long run, strategy adds most value and indeed is an area of significant importance specifically mentioned in the Myners Principles.
- The length of time given to Fund Managers to present is not sufficient to review their performance, their economic outlook and any potential business issues that they have. This leads to a more superficial review than we would suggest, and we believe that individual manager reviews should be more comprehensive.
- There would appear to be a duplication of effort, with the Officers and Independent Advisor reviewing investment managers, in addition to the managers' attendance at Committee meetings.
- Members seemed to be presented with a large amount of information of varying complexity, across all asset classes. This may be difficult for some Members to absorb in the short time available at the meeting.
- Given time constraints, it is not always possible to bring a manager or custodian to account in the way which may be appropriate. For example, it was difficult, due to time constraints, at the September Meeting to question Northern Trust on their foreign exchange charges and whether these were hampering fund managers in securing the most competitive foreign exchange rates.

Possible options

There are three main options open to the Fund, which we believe would result in a more effective and efficient governance structure. These options are formed by our experience of working with other pension fund clients, and are not necessarily mutually exclusive:

Refocus of Current Structure

The Fund could keep the existing set-up – albeit with each meeting agenda being more focussed - with more emphasis and time spent by the Elected Members on the Fund's investment strategy and monitoring at a Fund level. We suggest below a possible agenda:

- Minutes of last meeting
- Matters arising from minutes
- Fund Manager Performance covering:
  - overall market assessment and impact on investment strategy
  - investment performance of each manager
  - manager issues causing concern – why and recommended action
  - any significant changes in a Manager's characteristics
- Update on Fund Business Plan
- AOB

Such an approach would allow the Elected Members to focus more of their time on the most important topics, whilst at the same time allowing some of the more 'routine' items to be passed to the Officers, Independent Adviser and Consultants.

The Committee currently meets 6 times a year – with 4 meetings dedicated to monitoring and 2 dedicated to Fund business. We suggest that, should the Fund wish to continue with 6 meetings a year, that the priorities are changed, with 3 meetings dedicated to business and 3 dedicated to monitoring, at which the Committee would still see and review investment managers in person.

A possible arrangement might look like this:

Meeting 1: Fund Business issues

Meeting 2: Review Alliance Bernstein, Fidelity & Capital

Meeting 3: Fund Business issues

Meeting 4: Review Pantheon, Currency Managers (once in place), ING, Northern Trust

Meeting 5: Fund Business issues

Meeting 6: Review Alliance Bernstein, Fidelity & Capital

Officers would continue to review the managers every quarter, and the Committee could call a manager for review at any time – for example, if they were underperforming and causing some concern.

Use of a Sub-Committee

Another approach could be to create a Sub-Committee, which consists of some members of the Pensions Committee, Officers, and the Independent Advisor. Hewitt would also participate in the Sub-Committee meetings in its role as investment consultant.

The Committee could delegate responsibilities as it sees fit to the Sub-Committee. This new Committee could be a standing body, or could meet as and when deemed necessary – for example, to appoint an investment manager. Elected Members who sit on the main Pensions Committee could attend the Sub-Committee at any time they wish.

Again, such an approach would allow the main Pensions Committee to focus on the most significant aspects of managing the Fund, whilst delegating other arguably less critical areas down to the Sub-Committee.

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Delegating Responsibilities to Officers

The Committee could create an Investment Advisory Panel, to take on board some of the Fund's investment matters. Membership of the Panel could include the Officers, Independent Adviser and Investment Consultants. Any of the Pension Fund Committee Members could attend the Panel at any time. The purpose of the Panel would be to support the Committee, possibly including:

- Developing investment strategy.
- Monitoring investment managers.
- Monitoring investment management agreements and guidelines.
- Overseeing the rebalancing of the Fund's strategy.

Despite having the responsibilities listed above, the actual Pension Fund Committee would always have the final say on any pension fund matters.

The Panel would meet quarterly, carrying out its brief over 1-1.5 days. The Panel would produce a written report for the Committee each quarter, summarising the meeting and highlighting specific issues of interest.

With this new body being created, the burden on the Pension Committee would reduce. This might in turn permit the Committee to reduce the number of meetings from every two months, to meeting quarterly. The new 'core' agenda for the Committee might look like the following:

- Pensions Administration issues (including budget monitoring).
- Investment Advisory Panel Report.
- Investment Performance (long term, medium term, short term).

Clearly, the Committee would have the discretion to add any items to the agenda it saw fit – including asking specific investment managers to come in to be reviewed, if there were concerns.

Summary

LGPS Pension Fund Committees are asked to do a difficult job, in a rapidly changing complex environment. We firmly believe that Elected Members' limited time is best spent on 'high level' matters such as investment strategy, as opposed to aspects such as quarterly investment manager monitoring.

We would be happy to discuss this matter further with the Pensions Committee in due course, to gauge its interest and any appetite for change.

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Appendix – CIPFA Pensions Panel Principles

Principle 1: Effective decision making

Decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take.

Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities. Trustees should also be paid, unless there are specific reasons to the contrary.

It is good practice for trustee boards to have an investment sub-committee to provide the appropriate focus.

Trustees should assess whether they have the right set of skills, both individually and collectively and the right structures and processes to carry out their role effectively. They should draw up a forward-looking business plan.

Principle 2: Clear objectives

Trustees should set out an overall objective for the Fund that:

- Represents their best judgement of what is necessary to meet the Fund's liabilities given their understanding of the contributions likely to be received from employer(s) and employees.
- Takes account of their attitude to risk, specifically their willingness to accept underperformance due to market conditions.

Objectives for the overall Fund should not be expressed in terms which have no relationship to the Fund's liabilities, such as performance relative to other pension funds, or to market index.

Principle 3: Focus on asset allocation

Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflect the contribution they can make towards achieving the Fund's investment objective. Decision-makers should consider a full range of investment opportunities, not excluding from consideration any major asset class, including private equity. Asset allocation should reflect the Fund's own characteristics, not the average allocation of other funds.

Principle 4: Expert advice

Contracts for actuarial services and investment advice should be opened to separate competition. The Fund should be prepared to pay sufficient fees for each service to attract a broad range of kinds of potential providers.

Principle 5: Explicit mandates

Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustees and managers on:

- An objective, benchmark(s) and risk parameters that together with all the other mandates are coherent with the Fund's aggregate objective and risk tolerances.

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Principle 5: Explicit mandates (continued)

- The manager's approach in attempting to achieve the objective.
- Clear timescale(s) of measurement and evaluation, such that the mandate will not be terminated before the expiry of the evaluation timescale for underperformance alone.

The mandate and trust deed and rules should not exclude the use of any set of financial instruments, without clear justification in the light of the specific circumstances of the Fund.

Trustees, or those to whom they have delegated the task, should have a full understanding of the transaction related costs they incur, including commissions. They should understand all the options open to them in respect of these costs and should have an active strategy – whether through direct financial incentives or otherwise – for ensuring that these costs are properly controlled without jeopardising the Fund's other objectives. Trustees should not without good reason permit soft commissions to be paid in respect of their Fund's transactions.

Principle 6: Activism

The mandate and trust deed should incorporate the principle of the US Department of Labor Interpretative Bulletin on activism. Trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure the effectiveness of this strategy.

Principle 7: Appropriate benchmarks

Trustees should:

- Explicitly consider, in consultation with their investment manager(s), whether the index benchmarks they have selected are appropriate; in particular, whether the construction of the index creates incentives to follow sub-optimal investment strategies.
- If setting limits on divergence from an index, ensure that they reflect the approximations involved in index construction and selection.
- Consider explicitly for each asset class invested, whether active or passive management would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned.
- Where they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving the managers the freedom to pursue genuinely active strategies

Principle 8: Performance measurement

Trustees should arrange for measurement of the performance of the Fund and make formal assessment of their own procedures and decisions as trustees. They should also arrange for a formal assessment of performance and decision-making delegated to advisers and managers.

Principle 9: Transparency

A strengthened Statement of Investment Principles should set out:

- Who is taking which decisions and why this structure has been selected.

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Principle 9: Transparency (continued)	■ The Fund's investment objective. ■ The Fund's planned asset allocation strategy, including projected investment returns on each asset class and how the strategy has been arrived at. ■ The mandates given to all advisers and managers. ■ The nature of the fee structures in place for all advisers and managers, and why this set of structures has been selected.
Principle 10: Regular reporting	Trustees should publish their Statement of Investment Principles and the results of their monitoring of advisers and managers. They should send key information from these annually to members of these Funds, including an explanation of why the fund has chosen to depart from any of these Principles.