Pensions Panel

1 November 2018

Investment Strategy

Report by Director of Finance, Performance and Procurement

Summary

This paper updates the Panel with the ongoing work reviewing the Fund's Investment Strategy.

Recommendation

Officer's work with Fund advisers to develop the options around income based asset allocation, to include the advantages and disadvantages, for further consideration.

Background

1. The Pension Panel's Business Plan includes a priority relating to the Fund's Investment Strategy in respect of the Fund's strong asset performance, the need to ensure that the investment strategy remains aligned to meet its long term objectives and in the context of Environmental, Social and Governance (ESG) issues.

2. In addition, the Pension Fund's risk register includes the risk that there are insufficient funds to meet pension obligations resulting in the Fund changing to a higher risk investment strategy and that the Pension Fund does not provide a clear and suitable investment strategy for Fund managers to follow. It should be noted that where there is evidence to suggest that an authority is acting unreasonably, it may be appropriate for the Secretary of State to consider intervention.

3. Following the decisions made by the Pensions Panel in respect of the Pension Fund's investment strategy framework it is appropriate for the Pensions Panel to consider asset types in consideration of its 'income' strategic allocation.

4. The Pension Panel has determined a set of Investment Beliefs to inform its decision making. These are shown in Appendix A.

GrIP Framework

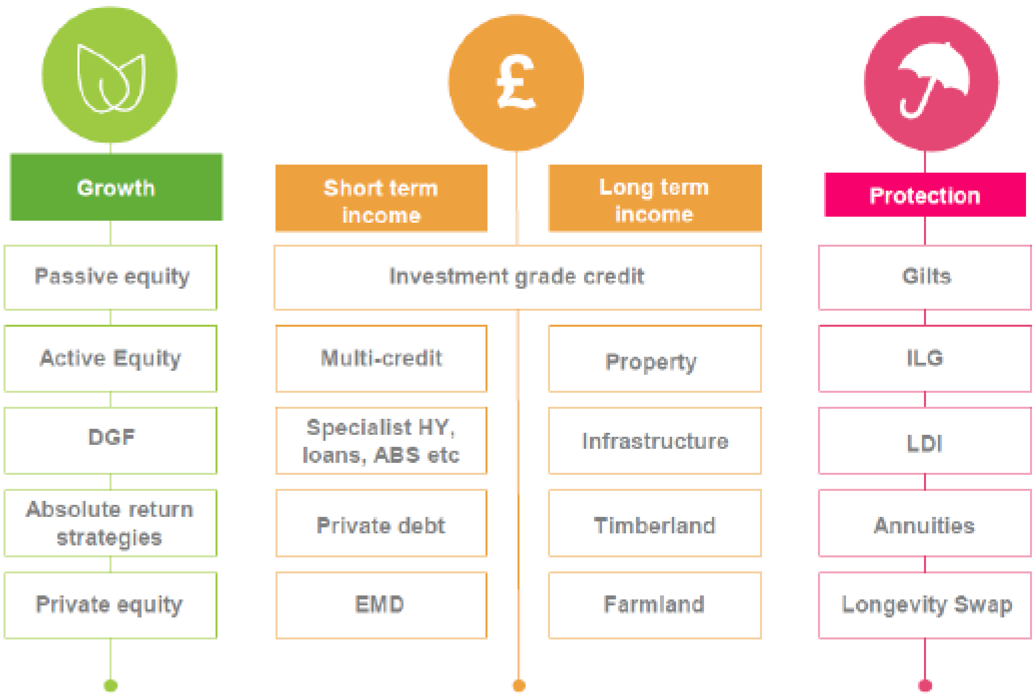
5. The Pensions Panel have considered the Fund's investment strategy in the context of the de-risking triggers being exhausted and the strong funding position being maintained by the Fund.

6. As a result the Fund's investment strategy has been considered in broad terms – growth assets, income assets and protection assets – with a strategic allocation as set out below.

Asset Type and Role	Asset	Strategic	Geography

	Class	Allocation	
Growth • Generate returns in line with equities • Provide liquidity for de-risking • Keep contributions affordable	Listed Equity	40.0%	Diversified
	Private Equity	0.0%	Diversified
Income • Generate a reliable income providing additional cash flows if required • Additional yield versus protection assets	Direct property	10.0%	UK
	[TBD]	10.0%	[TBD]
Protection • Change value in line with liabilities • Protect against movements in interest rates and inflation expectations • Provide liquidity for re-risking • Keep contributions stable	Bonds	40.0%	Diversified

7. The asset classes set out above reflect the Fund's current allocations. The illustration below shows potential alternative asset classes:



Income Assets

Characteristics

8. Income assets sit between "Growth" and "Protection" assets in respect of their anticipated risk and return profile. For this reason they are considered beneficial to the Fund to provide diversification and can assist in the achievement of the long term funding objectives through delivering a predictable and stable return, meaningfully higher than what can currently be achieved through investing in cash or long-term index-linked government bonds, ideally with a degree of reasonable long-term inflation linkage.

9. Importantly investing in the income asset classes broadly maintained the expected level of returns, and therefore could still maintain the ambition to reduce employer contribution rates over time.

Considerations

10. Pension Panel Members attended an informal session on 12 September led by David Walker from Hymans Robertson which considered income asset types in some detail in order to provide background to the Panel and facilitate any questions or issues arising.

11. During the session the Panel considered the following asset classes:

- Infrastructure
- Investment Grade Credit
- Liquid Credit (High Yield, Loans and Asset-Backed Securities)
- Illiquid Credit (Private Debt and Real Estate Debt)

12. The key asset classes highlighted for further investigation were infrastructure and private debt. The rationale for considering these asset classes were as follows:

- The current market outlook for these assets looks attractive relative to many other asset classes
- Both infrastructure and private debt have a strong income component to the return stream giving some visibility and increased confidence over the expected returns that can be achieved
- Both asset classes are relatively illiquid investments but this is aligned to the long term investment horizon available to the Fund, which can benefit from the illiquidity premium
- Both offer attractive levels of risk adjusted returns which are aligned to the investment and funding requirements of the Fund

13. A further informal meeting could be considered to allow a focus on this work.

Independent Adviser

14. Note that the Fund's Independent Adviser was unable to attend the informal Pension Panel meeting on 12 September but comments can be supplied for the Panel meeting and also as the detailed options are progressed.

Impact of Pooling

15. It is unlikely that the ACCESS Pool will have a solution for either asset class prior to 2021. Therefore the Fund may need to consider appropriate options for its investment in the shorter term.

Options for Further consideration:

16. It is proposed that Officers and advisers progress the above considerations prior to the Pension Panel meeting in January reflecting on:

- Size of Allocation: It is considered that a minimum allocation of 5% of total fund assets is required to have an impact. However allocations of 10% to a single asset class may take time to implement.
- Appropriate strategy, risk and return profile for any investments: Based on liquidity, yield, timescales, cost and governance.
- Procurement and implementation considerations: Products, whole of market search etc.
- The pros and cons of the allocations under consideration

Implementation Period

17. Irrespective of the asset class / classes allocated to, the implementation period for infrastructure or private debt is likely to be 2-3 years. It is therefore appropriate for the Pension Panel to consider the level of risk being run by the Pension Fund ahead of any new mandates being funded. The allocation to income assets will be drawn from the current growth strategies, which presents a higher risk of the funding level falling back from current levels than if the new income solutions had been funded.

18. An interim 'de-risking' solution could be achieved by moving some "Growth" assets into "Protection" assets within the existing bond mandates, or cash.

19. However Hymans Robertson have suggested that there is no immediate need to take action to reduce risk for the following reasons:

- The Fund is a long term investor and while short term falls in asset values are undesirable the Fund is well placed to withstand this volatility
- The Fund already has a sizeable allocation to liquid liability focussed protection assets as a result of previous de-risking steps. This provides a strong buffer from adverse asset movements and a liquid source of funding should there be a need to rebalance back into higher return seeking assets
- The investment and funding framework is robust and now has a sizeable funding buffer that means contributions should withstand short term market volatility
- There would be costs associated with any implementation.

Growth and Protection Assets

20. Further consideration of appropriate growth and protection asset classes will be considered in the future.

21. In the context of Pooling, work has been commissioned on behalf of ACCESS Authorities to consider the appropriate mix of fixed income sub-funds. This could facilitate alternative implementation for the Fund as a whole or for employer strategies.

Katharine Eberhart

Director of Finance, Performance and Procurement

Contact: Rachel Wood, Pension Fund Strategist, 033 022 23387

Appendices
Appendix A - Investment Beliefs