Scottish Borders COUNCIL

# STRATEGIC INVESTMENT REVIEW

**Report by Chief Financial Officer**

## JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION FUND BOARD

## 15 September 2016

### 1 PURPOSE AND SUMMARY

1.1 **The report provides the Committee and Board with an update on the outcome of the Strategic Investment Review and presents the resulting recommendations for the revised asset allocation**.

1.2 The Investment strategy is a key to ensuring assets continue to grow to meet the long term liabilities of the fund and that as far as possible the contribution rates from employers remain stable.

1.3 A review of the current strategy has been undertaken by KMPG and the findings are detailed in Appendix 1. Para 5.2 details the recommended revised asset allocation.

1.4 As part of the review the currency hedge arrangement was also reviewed and the findings are detailed in Appendix 2. The removal of the currency hedge is now recommended.

### 2 STATUS OF REPORT

2.1 Due to the timing of the finalisation of this report consultation comments will be reported verbally at the meeting.

### 3 RECOMMENDATIONS

3.1 **It is recommend that the Joint Pension Fund Committee and Pension Fund Board:-**

**(a) Agree the investment strategy as detailed in para 5.2;**

**(b) Agree the removal of the Currency Hedge;**

**(c) Delegate authority to the Chief Financial Officer, in agreement with the Chair of the Pension Fund Committee, and based on advice of the Investment Advisor to implement the revised investment strategy; and,**

**(d) Delegate authority to the Chief Financial Officer, in agreement with the Chair of the Pension Fund Committee, and based on advice of the Investment Advisor the removal of the currency hedge at the most appropriate time.**

## 4 BACKGROUND

4.1 The Pension Fund is required by the Local Government Pension Scheme (LGPS) Regulations to have an up-to-date Statement of Investment Principles (SIP). A key part of the SIP is the strategic asset allocation which sets the allocation of investments across the different asset classes.

4.2 The Funds primary aim is "To provide for members' pension and lump sum benefits on their retirement or for their dependants' benefits on death before or after retirement, on a defined benefits basis". To meet this aim the Fund must ensure it sets levels of contributions that will build up a fund of assets sufficient to meet all future benefit payments.

4.3 The Fund while setting the contributions rates aims to ensure the rates payable by employers are as stable as possible. To reduce the volatility of rates the Fund must ensure there is stability and the required level of returns from the investments.

4.4 The last review of the strategic asset allocation was undertaken in December 2013 following the 2011 tri-annual revaluation. The outcome of this was incorporated into the current SIP and was fully implemented.

4.5 On 18 June 2015 following the appointment of a new Investment Advisor KPMG the Committee approved that a full strategic review should be undertaken to determine the future strategic asset allocation.

## 5 STRATEGIC REVIEW

5.1 KPMG has undertaken a full review of the current investments within the fund and found the Fund has performed well over the last 5 years with returns above the required levels. The fund however is heavily exposed to both Global and UK equities, which although they have performed well in the past and could do in the future, have no direct link to the increasing liabilities arising through inflation, interest rates and changing member demographics.

5.2 **Appendix 1** details the full findings of the review and the table below details the resulting recommended changes to the asset allocation:

| Asset Group | Current Position | Recommend Position | Move-ment |
|---|---|---|---|
| Equities | 65% | 50% | (15%) |
| Diversified Alternatives | 15% | 10% | (5%) |
| Balance Property | 5% | 5% | - |
| Long Lease Property | - | 10% | 10% |
| Private Credit | 10.5% | 10% | (0.5%) |
| Corporate Bonds | 2.25% | - | (2.25%) |
| Fixed Income Gilts | 2.25% | - | (2.25%) |
| Index Linked Gilts | | 5% | 5.0% |

5.3 The transition to the recommended revised strategy will take time and require disinvestment of some funds and the establishment of some new funds. It is proposed this is done on a phased based as detailed in Appendix 1, using existing Managers where possible to minimise the cost of transition. The timescales for moving to the new strategy is estimated at this point to be around 12-18 months and any revision to this timescale will be reported to committee.

5.4 The currency hedge was also reviewed as in conjunction with the strategy. **Appendix 2** details the work undertaken and the recommendation to cease the current hedge. The timing of withdrawal from the hedge will need to be managed to ensure any potential loss is minimised.

## 6 IMPLICATIONS

### 6.1 Financial

(a) The revised asset allocation will require the establishment of new portfolios within the Fund. To minimise the costs of procurement Officers in conjunction with the Investment Advisor will investigate the use of existing Managers where possible.

(b) The timing of the disinvestment and unwinding of the currency hedge could result in losses for the Fund. To ensure any loss is minimized Officers in conjunction with the Investment Advisor will plan the timing of movements and will utilise the services of the existing Transition Manager, State Street.

### 6.2 Risk and Mitigations

(a) The Fund is becoming more mature as the number of deferred and retired members now exceeds higher than those currently contributing. This will result in the negative cashflow as the monthly payments to Pensioners will be greater than the contributions collected. The Fund will in future need to generate more liquid cash in order to pay pensioners and the current arrangements, whereby dividends are directly reinvested back into the portfolios. may require to be reviewed with some element of this income returned the Fund to allow payment of pensioners.

(b) The terms of the scheme allow for annual CPI inflation increases in pension payments. There is a risk that this may result in increased liabilities which outstrip any growth in investments. To mitigate this risk the investments require to be diversified into areas which match the liability growth rate.

(c) The recent "Bretix" vote has had significant impact on the markets and as the details of the break from EU continue to emerge there will be further uncertainty. This uncertainty is likely to have an impact on the valuation of the liabilities during the 2017 tri-annual valuation.

(d) Discussions are currently underway with the actuary Barnett Waddingham, in advance of the 2017 valuation to assess the impact of Brexit and the proposed impact of the revised asset allocation strategy on the net liability position of the Fund and the overall funding level.

6.3 **Equalities**

An Equalities Impact Assessment has been carried out on this proposal and it is anticipated that there are no adverse equality implications.

6.4 **Acting Sustainably**

There are no direct economic, social or environmental issues with this reports which would affect the Council's sustainability

6.5 **Carbon Management**

There are no direct carbon emissions impacts as a result of this report.

6.6 **Rural Proofing**

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

6.7 **Changes to Scheme of Administration or Scheme of Delegation**

No changes are required as a result of this report.

## 7 CONSULTATION

7.1 The Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Chief Officer HR and the Clerk to the Council have been consulted and any comments will be given at the meeting.

**Approved by**

**Name**
**Title** **Signature .....**

**Author(s)**

| Name | Designation and Contact Number |
|---|---|
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**Background Papers**
**Previous Minute Reference:** Pension Fund Committee and Pension Fund Board, 16 June 2016

**Note –** You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Capital and Investment Team can also give information on other language translations as well as providing additional copies.

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