Scottish Borders COUNCIL

STRATEGIC INVESTMENT REVIEW

Report by Chief Financial Officer

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION FUND BOARD

13 September 2018

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 in consultation with officers and the findings are detailed in Appendix 1. Para 4.3 details the recommended revised asset allocation.

2 RECOMMENDATIONS

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

(a) Agree the investment strategy as detailed in para 4.3;

(b) Delegate authority to the Chief Financial Officer, in consultation with the Chair of the Pension Fund Committee and based on the advice of the Investment Advisor to implement the outcome of a review of the number of equity managers; and

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

3 BACKGROUND

3.1 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.

3.2 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.

3.3 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.

3.4 The last review of the strategic asset allocation was undertaken in December 2016 following the 2014 tri-annual revaluation and the appointment of KPMG as Investment Advisor. The outcome of this was incorporated into the current SIP and good progress has been made to implement it.

3.5 The results of the triennial valuation on 31 March 2017 have seen the funding position of the Fund increase from 101% to 114%. It was agreed in the Business Plan on 16 June 2018 in line with good practice to undertake a health check of the current SIP following these results.

4 STRATEGIC REVIEW

4.1 KPMG has undertaken a health check of the current investments within the fund and found the Fund has continued to perform well over the last 5 years with returns above the required levels. The fund however, due to the strong performance of equities, still remains exposed to the risks inherent in investing in both Global and UK equity markets. The markets have performed well over the period, however equities have no direct link to the increasing liabilities arising through inflation, interest rates and changing member demographics and the review therefore recommends a reduction in the funds exposure to this asset class.

4.2 The fund is well diversified across a range of both public and private markets and the new assets groups introduced in the last two years have seen more of the fund's investments now being held in inflation linked assets with lower risk profiles. With the improvement in the funding positon and the recent strong market performance of equities there is an opportunities for the fund to further reduce its equity exposure risk and to move to longer term more illiquid assets which are characterised by lower inherent volatility and which provide an element of inflation linkage.

4.3 The new strategy recommends an investment in infrastructure debt which it is felt will help to provide greater diversification, reduce the funds exposure to equity risk and provide a greater element of inflation protection. 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	47.5%	40.0%	(7.5%)
Diversified Alternatives	7.5%	7.5%	-
Balance Property	5%	5.0%	-
Long Lease Property	10.0%	10.0%	-
Direct lending	10.0%	10.0%	-
Infrastructure (including Junior Infrastructure debt)	5.0%	7.5%	2.5%
Index Linked Gilts	5.0%	5.0%	-
Diversified Credit	10.0%	10.0%	-
Infrastructure Debt (senior)		5.0%	5.0%

4.4 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.

4.5 With the recommended reduction of equities it is proposed a review is undertaken regarding the number of equity managers the fund current invests with. This will be undertaken prior to the withdrawal of funds from equities.

5 IMPLICATIONS

5.1 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 recommended additional allocations to Infrastructure Debt will not incur stamp duty or large one off fees for implementation. The review of equity managers will include the effect on the fees and look to ensure best value is achieved with the best blend and number of managers.

5.2 Risk and Mitigations

(a) The Fund is becoming more mature as the number of deferred and retired members now exceeds those currently contributing. This has resulted in a negative fund cashflow as the monthly payments to Pensioners are now greater than the contributions collected through payroll. The Fund therefore needs to generate more liquid cash in order to pay pensioners and the current arrangements, whereby dividends are directly reinvested back into the portfolios. The mix of

investments required to meet the funds cashflow obligations requires to be kept under review to ensure the Fund generates the monthly cash income returned the Fund to allow payment of pensioners.

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

(c) The uncertainty associated with "Brexit" continues to impact on the markets as the details of the separation from the EU continue to emerge. This uncertainty is likely to have an impact on the markets for some time to come.

(d) In line with the Corporate risk management approach the Pension Fund maintains a full risk register which is fully reviewed on an annual basis and reports are submitted to the Joint Pension Fund Committee and Board on a quarterly basis updates on ongoing mitigation actions. Any new risks identified are added to the risk register on an ongoing basis.

5.3 **Equalities**

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

5.4 **Acting Sustainably**

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

5.5 **Carbon Management**

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

5.6 **Rural Proofing**

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

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

No changes are required as a result of this report.

6 CONSULTATION

6.1 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 have been incorporated into the report.

Approved by

David Robertson **Signature .....**
Chief Financial Officer

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Pension & Investment Manager, 01835 825249

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 Pension & Investment Team can also give information on other language translations as well as providing additional copies.

Contact us at Contact us at: Pension & Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825249 Fax 01835 825166.
email: treasuryteam@scotborders.gov.uk