ABERDEEN CITY COUNCIL

COMMITTEE	Pensions Committee
DATE	17 December 2021
EXEMPT	No
CONFIDENTIAL	No
REPORT TITLE	Investment Buckets – Risk Management
REPORT NUMBER	PC/DEC21/RISK
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TERMS OF REFERENCE	1.1

1. PURPOSE OF REPORT

1.1 To seek approval from Committee around the intention to adopt 'investment buckets' as a risk strategy for managing liabilities at an employer level.

2. RECOMMENDATIONS

That the Committee: -

2.1 approve that the Pension Fund Manager move forward with the policy on Investment Buckets and continue work around issuing a consultation on the amended Funding Strategy Statement; and

2.2 note that further information on the investment buckets, assumptions and implementation will be provided to Committee in the form of the draft Funding strategy Statement in June 2022.

3. BACKGROUND

3.1 <u>2020 Consultation</u>

3.1.1 As part of the consultation to all participating employers on the NESPF Funding Strategy Statement 2020 the Fund introduced the idea of adopting different investment strategies as a method of managing risk at an employer level.

3.1.2 Adopting different investment strategies enables some employers to move into lower risk strategies. This would create more certainty around investment returns where they want to protect any funding gains or are looking to exit the scheme in the short or medium term.

3.1.3 Investment buckets also provide another tool for the Fund to manage high risk employers and protect the participating employers in relation to orphaned liabilities.

3.1.4 The consultation responses from employers welcomed this proposal on the understanding that more information would be provided and the impact of these different strategies on funding levels and contribution rate requirements were clearly understood by all employers.

3.2 Investment Buckets

3.2.1 Mercer, the scheme actuary, was asked to consider this proposal further to understand the approach that the Fund could take and how to implement it.

3.2.2 Mercer have identified the potential to introduce three 'investment buckets' that would be appropriate for the employer profile within the NESPF. Each bucket would have a clear investment strategy with different funding assumptions around assets returns being applied at the triennial valuation.

3.2.3 The buckets would be as follows:

Higher Risk

3.2.4 This bucket would hold the vast majority of the liabilities within the Fund (c90%-95%) and represents the current investment strategy and asset allocation. This balanced portfolio holds a combination of return seeking assets and lower risk alternatives along with corporate bonds and cash held.

3.2.5 The employers within this bucket would include all scheduled bodies and employers with a stable liability profile. These employers would benefit fully from any positive return on assets but would also be fully exposed to any investment lows (as per the current strategy.) The employers have the potential to achieve higher returns over the long term but the certainty that the actuary can put on achieving this is reduced.

Medium Risk

3.2.6 This bucket is similar to the higher risk bucket however the allocation of equities to this strategy would be reduced, therefore reducing the risk and increasing the certainty around investment returns.

3.2.7 From a valuation perspective, given the lesser reliance on equites, this bucket would have a lower discount rate (asset returns expectation) applied for valuation purposes. The greater certainty around achieving these returns would mean that there would be less volatility and assuming that this is done whilst funding is positive, it may not result in an increase in employer contribution requirement.

3.2.8 Employers may wish to move into this bucket if they are looking to close the scheme to new entrants or are anticipating an exit from the scheme in the foreseeable future due to a maturing membership profile. They may also want to move into this bucket if they wish to lock down and protect the assets currently held given the current very positive funding position.

Low Risk

3.2.9 This bucket would be used by employers and the Fund to manage both orphaned liabilities and any employers that potentially wish to exit or are looking to fund for termination.

3.2.10 This bucket would have no exposure to return seeking assets and would rely solely on very low risk assets such as corporate bonds, gilts and cash. The Fund and employers give up the ability to seek high asset returns for the certainty around how the pension liabilities are calculated and the impact on the funding level.

3.2.11 This level of certainty gives the Fund comfort in the ability to meet future liabilities but also allows employers certainty around the cost of exiting the scheme. As a result of introducing this bucket it would allow the Fund to take a less prudent approach around termination calculations and stop employers from being trapped within the scheme due to the high cost of exit.

3.2.12 As with the medium bucket, different actuarial assumptions would be applied to liabilities held in this bucket as part of the triennial valuation. Specifically, this bucket would attract a much lower discount rate and would increase the contribution requirements for any active employers within this tranche.

3.2.13 The actual asset allocations and associated assumptions for each bucket are still under review. These will be outlined with the amended Funding Strategy Statement once determined.

3.3 <u>Implementation</u>

3.3.1 Due to the size of the NESPF and the potential amount of liabilities that will be held in each bucket the investment strategies will be done as a notional strategy. By taking a notional approach this will reduce both the cost and the administrative burden around the investment assets.

3.3.2 By taking a notional approach this proposal becomes an actuarial proposition. Mercer will be required to identify the liabilities held within each bucket and apply the appropriate asset return figures to each bucket depending on the returns for each asset class.

3.3.3 Although employers will have three buckets in which they can choose to invest, there is no change to the Fund's investment strategy and its current holding of assets.

3.3.4 The Fund will only offer the investment strategies available through these three buckets. No individual funding strategies will be implemented for any one employer due to the complexity and cost of administering a request of this nature.

3.3.5 This strategy is intended to be another tool for the NESPF to manage risk at an employer level. There will be no requirement for participating employers to move to an alternative investment strategy should they not wish to do so.

3.4 <u>Consultation 2022</u>

3.4.1 As a result of the adoption of the new strategies, amendments will be required to the NESPF Funding Strategy Statement and Termination Policy (embedded with the Funding Strategy Statement). As per the Local Government Pension Scheme (Scotland) Regulations a full consultation, subject to Committee approval, with all participating employers will be required on the changes made.

3.4.2 Following further conversations with the scheme actuary, the Fund intend to implement this policy in Summer 2022 with the consultation taking place in March or April to incorporate this policy and the changes to be made around Deferred Debt Arrangements.

3.4.3 Employers will be provided with further details on the policy to ensure that there is an understanding of the benefit implications of managing liabilities and risk in this manner. This will be delivered through employer communications and the 2022 financial forum.

3.4.4 The draft Funding Strategy Statement will be taken to Pensions Committee in 2022 prior to implementation of the plan.

4. FINANCIAL IMPLICATIONS

4.1 Actuarial costs will increase as a result of the implementation of the buckets due to the amount of work that will need to be carried out for the triennial valuation and inter-valuation review. Risk management is an essential requirement for the Fund and its participating employers.

4.2 Mis-management of this policy could result in the Fund not being able to meet the cost of future liabilities which places a burden on the participating employers and the taxpayer.

5. LEGAL IMPLICATIONS

5.1 As outlined above the Local Government Pension Scheme (Scotland) Regulations provide that consultation is required with all appropriate stakeholders prior to any changes being made to the Funding Strategy Statement. Any movement to a lower risk investment strategy by an active employer will require a formal agreement to ensure that the decision is documented.

6. MANAGEMENT OF RISK

Category	Risk	Low (L) Medium (M) High (H)	Mitigation
Strategic Risk	N/A	N/A	N/A
Compliance	Consultation with participating employers on the	L	Consultation planned for early 2022.

	changes is required under the LGPS (Scotland) Regulations.		
Operational	Further monitoring and administration required in addition to extra reliance on actuarial services.	L	Undertaken as part of the employer monitoring and risk management requirements.
Financial	Additional actuarial and legal costs will be incurred as a result of implementing the policy. Inability of employer to meet exit debts.	M	Careful monitoring of the agreement, employer covenant and reassessment requirements. This plan and additional monitoring required will reduce the extremely high cost of exit going forward.
Reputational	Poor management of this policy may result in reputational risk.	L	Working closely with the scheme actuary and reviewing the policy regularly.
Environment / Climate	N/A	N/A	N/A

7. OUTCOMES

7.1 This report does not impact on the Council Delivery Plan.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Impact Assessment	Not required
Data Protection Impact Assessment	Not Required

9. BACKGROUND PAPERS

None

10. APPENDICES

None

11. REPORT AUTHOR CONTACT DETAILS

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