North East Scotland Pension Fund

Investment Strategy Review

June 2024

Actuarial Valuation 2023 & Funding Strategy Statement

Valuation Date	31 March 2017 £'s	31 March 2020 £'s	31 March 2023 £'s
Asset Value	3,815 m	4,367 m	5,804 m
Liabilities	3,576 m	4,254 m	4,614 m
Surplus/(Deficit)	239 m	113 m	1,190 m
Funding Level	**107%**	**103%**	**126%**

Actuarial Valuation

As shown in the above table, the Fund has a strong funding level, outperforming the target funding level of 100%. Having reached this position it is now very important that the Fund implements a balanced investment strategy that locks in this funding level and protects this position going forward; whilst recognising the Fund is still an open Fund.

Funding Strategy Statement

The Local Government Pension Scheme (Scotland) Regulations 2018 (as amended) (the '2018 Regulations') and the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 (the '2014 Transitional Regulations') (collectively 'the Regulations') provide the statutory framework from which the administering authority is required to prepare a Funding Strategy Statement (FSS).

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the administering authority, acting on the professional advice provided by the scheme actuary.

The administering authority's long term objective is for the Fund to maintain a 100% solvency level over a reasonable time period and then sufficiently manage assets in order for it to pay all benefits arising as they fall due.

The purpose of the Funding Strategy Statement (FSS) is therefore:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward by taking a prudent longer-term view of funding those liabilities;

- to establish contributions at a level to 'secure the solvency' of the Pension Fund and the 'long term cost efficiency'; and

- to have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the administering authority to implement and maintain.

Delivery of the Funding Strategy is through a combination of scheme contributions (both member and employer) and the Fund's investment Strategy.

This report sets out the Fund's current investment strategy and proposal for its development over the next valuation period.

Investment Strategy

Despite the time spent by Pension Funds on the appointment, review and selection of fund managers, investment strategy and the development of the strategic benchmark (Alpha) accounts for around 80 - 90% of the performance of a pension fund's assets.

Investment strategy should be determined in order to meet the Fund's particular requirements, with specific reference to the funding position and liability profile, and to the Fund objectives. It need not reflect a standard 'mould' or 'model'; rather it should be based on sound rationale specific to the Fund's own circumstances. In theory every fund should have a different asset allocation policy.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which more closely matches the liabilities and represents the minimum risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

Investment of the Schemes' assets in line with the minimum risk portfolio would minimise fluctuations in the Schemes' ongoing funding level between successive actuarial valuations.

Departure from a minimum risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will stabilise the contribution requirements and move towards/maintain the funding target (100%). The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The current FSS incorporated the following global strategy asset allocation as appropriate to meet the long term objective of maintaining 100% funding:

<u>Growth Assets 55.0% (range +/- 5%)</u>
Global Equities 50.0%
Limited Partnerships 5.0%

Income/Protection Assets 45.0% (range +/- 5%)
Bonds/Credit 22.5%
Direct Property 10.0%
Infrastructure 10.0%
Other 2.5%

2023 Investment Strategy Review

During the 2023 Investment Strategy review a number of topics were considered including:

a) Re-balancing the Equity profile and overweight
b) The role of each mandate as a contribution towards Investment Strategy
c) Potential to add more Credit opportunities and Index Linked Gilts
d) Income requirements and cashflow negativity
e) Environmental, Social & Governance issues

Changes made since the last review of the Fund include;

a) Further investments in Direct Lending, Credit and Infrastructure.

Investment Strategy 2024

Having taken all the above into consideration, which importantly includes the current funding position of 126%, the Fund should look to achieve its rebalancing target and lock in recent gains.

To achieve this, the Fund needs to reduce its growth asset allocation and increase its income/protection allocation. This can be done by reducing Global Equities and increasing Bonds/Credit assets.

The proposed move between Growth and Income/Protection will be phased over time taking into account trigger points and market conditions. In terms of the top line Investment Strategy, Officers recommend that this can remain the same:

Current Strategic Benchmark	Proposed Strategic Benchmark
Growth Assets 55.0% (+/- 5%)	**Growth Assets 55.0% (+/- 5%)**
Global Equities 50%	Global Equities 50%
Limited Partnerships 5%	Limited Partnerships 5%

Income/Protection Assets 45.0% (+/- 5%)	Income/Protection Assets 45.0% (+/- 5%)
Bonds/Credit 22.5%	Bonds/Credit 22.5%
Property 10%	Property 10%
Infrastructure 10%	Infrastructure 10%
Other 2.5%	Other 2.5%