ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	16 MARCH 2018
REPORT TITLE	INVESTMENT STRATEGY REVIEW 2018
REPORT NUMBER	PC/MAR18/REVIEW
DIRECTOR	DIRECTOR OF RESOURCES
REPORT AUTHOR	LAURA COLLISS

1. PURPOSE OF REPORT:-

1.1 This report details the outcome of the investment strategy review which has been prepared by officers following the outcome of the 2017 Actuarial Valuation. This report sets out the details of the Fund's current investment strategy and makes a number of recommendations on taking the strategy forward over the next 5 to 10 years.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Approve the proposed investment strategy as set out in section 3.5 and Appendix I of the report.

3. BACKGROUND/MAIN ISSUES

3.1 The Fund's established practice is to complete a review of its investment strategy following the outcome of each triennial actuarial valuation.

The aim of the investment strategy is:

- To restore any Fund deficit position through investment returns and agreed contributions to achieve 100% funding but also consider what investment policy the Fund would have when fully funded.

- To provide a framework for identifying changes required over the coming period to continue and maintain the appropriate funding level.

3.2 **Actuarial Valuation 2017 & Funding Strategy Statement**

Valuation Date	31 March 2011 £'s	31 March 2014 £'s	31 March 2017 £'s
Asset Value	2,218	2,834	3,815
Liabilities	2,512	3,025	3,562
Surplus/(Deficit)	(294)	(191)	253
Funding Level	**88%**	**94%**	**107%**

3.2.1 Actuarial Valuation

As shown in the above table, the Fund has continued to increase its funding level, outperforming the target funding level of 100%. Having reached this position it is now very important that the Fund implements an investment strategy that locks in this funding level and protects this position going forward.

3.2.2 Funding Strategy Statement

3.2.2.1 The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) (the '2014 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').

3.2.2.2 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.

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

3.2.2.4 The purpose of this Funding Strategy Statement 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.

3.2.2.5 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.

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

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

3.3 <u>Investment Strategy</u>

3.3.1 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.

3.3.2 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.

3.3.3 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 least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

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

3.3.5 **<u>However</u>**, if at the last valuation date, the Fund had been invested in this portfolio, then in carrying out the valuation it would not have been appropriate for the actuary to make any allowance for out-performance of the investments. On this basis of assessment, the assessed values of the Funds' liabilities would have been significantly higher, declaring a funding level of 88%.

3.3.6 Departure from a least 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.

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

<u>Growth Assets 70% (range +/- 5%)</u>
Global Equities 55%
Diversified Growth 10%
Limited Partnerships 5%

<u>Income/Protection Assets 30% (range +/- 5%)</u>
Bonds 10%
Direct Property 10%
Index Linked 5%
Other 5%

3.4 **2016 Investment Strategy Review**

3.4.1 During the above review a number of topics were considered including:

a) Increased diversified asset allocation
b) Liability Driven Investments
c) Trigger Points
d) Passive Currency Hedge
e) Fund Manager Benchmarks
f) Infrastructure

3.4.2 During the period since this last review the Fund has addressed the above areas by;

a) Diversified its asset allocation, investing in multi Credit, Index Linked bonds, diversified growth funds and infrastructure
b) Taken first steps into liability driven investments with a 5% allocation to Index Linked bonds
c) Continued to work within the risk based framework (Appendix I)
d) Passive Currency Hedge, continues to be under review and will be further addressed once the Global Custodian change has been implemented

e) Fund Manager benchmarks have been reviewed, with some changes being made within the alternative asset allocation
f) The Fund has recently invested £100m in an Infrastructure Fund and continues to look for suitable opportunities.

3.5 **Investment Strategy 2018**

3.5.1 Having taken all the above into consideration which importantly includes the current funding position of 107% the Fund should look to de-risk and lock in recent gains.

3.5.2 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 Bond/Credit assets while introducing an allocation to Infrastructure that will assist in the matching of liabilities.

3.5.3 The proposed move between Growth and Income/Protection will be phased over time taking into account trigger points and market conditions. In the first instance Officers recommend the following change:

Current Strategic Benchmark	**Proposed Strategic Benchmark**
Growth Assets 70% (+/- 5%)	**Growth Assets 57.5% (+/- 5%)**
Global Equites 55%	Global Equities 45%
Diversified Growth Funds 10%	Diversified Growth Funds 7.5%
Limited Partnerships 5%	Limited Partnerships 5%
Income/Protection Assets 30% (+/- 5%)	**Income/Protection Assets 42.5% (+/- 5%)**
Bonds/Credit 10%	Bonds/Credit 15%
Property 10%	Property 10%
Index Linked 5%	Infrastructure 10%
Other 5%	Index Linked 5%
	Other 2.5%

3.5.4 Further reductions in Growth assets will be implemented as per Appendix I if and when Funding levels and market conditions allow. Any further changes will be brought to Committee for approval.

4. FINANCIAL IMPLICATIONS

4.1 All Pension Fund costs are paid for by the Fund.

5. LEGAL IMPLICATIONS

5.1 As noted in section 3. 2 the strategy is in line with the legal requirements stipulated in the Regulations.

6. MANAGEMENT OF RISK

6.1 The Pension Fund regularly updates its Risk Register in line with change and is reported quarterly to the Pensions Committee.

7. IMPACT SECTION

7.1 The Pensions Committee has a fiduciary duty to monitor the Pension Fund Strategies across all areas and timelines to deliver a timely, accurate and compliant service to all stakeholders.

8. BACKGROUND PAPERS

8.1 None

9. APPENDICES

9.1 **Appendix I**, Strategic Benchmark Allocation

10. REPORT AUTHOR DETAILS

Laura Colliss
Pension Fund Manager
lcolliss@nespf.org.uk
01224 264158

DIRECTOR DETAILS

Steven Whyte
Director of Resources
swhyte@aberdeencity.gov.uk
01224 523566