

**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE: 14 FEBRUARY 2014**

**LEAD OFFICER: SHEILA LITTLE, CHIEF FINANCE OFFICER**

**SUBJECT: INVESTMENT STRATEGY REVIEW**



14

**SUMMARY OF ISSUE:**

Following the actuarial valuation, Mercer has been requested to conduct an investment strategy review of the Surrey Pension Fund.

**RECOMMENDATIONS:**

It is recommended that the Pension Fund Board:

- 1 Give consideration to investing in a more risk aware manner relative to the Fund's liabilities with a view to the establishment of a liability driven investment strategy (LDI) portfolio. This should be set up on a relatively small scale initially with the level of liability protection increased as and when the funding level moves towards 100%.
- 2 Give consideration to introducing more diversified sources of return with a view to introducing Infrastructure Debt as a new asset category and increasing the allocation to diversified growth funds (DGF).
- 3 Give consideration to implementing such changes in the short term, thus preparing a platform for the future strategy requirements, with the ultimate view to locking in some of the improvement in the funding level that has been seen since the valuation date of 31 March 2013.
- 4 Prepare additional training for members in order to facilitate decision making on these strategy issues.

**REASON FOR RECOMMENDATIONS:**

The Pension Fund Board must monitor and adapt its investment strategy according to a changing market environment.

**DETAILS:**

**Background**

- 1 This report provides both a summary of the deliberations that that need to be considered by the Pension Fund Board in order that Members can review the current investment strategy in light of the 2013 Triennial Actuarial Valuation outcome.

- 14
- 2 The Triennial Valuation cycle provides a good point at which to review the investment strategy as we have a current valuation of the liabilities of the Fund. The changes in funding level between one triennial valuation and the next is effectively the best measure of how the Fund's liabilities are developing with respect to changing bond yields in the market, and how the investment strategy has performed, relative to expectations, in those same investment markets.
  - 3 The Fund's current investment strategy was agreed by the Investment Advisory Group (IAG) in early 2012. At that time, the most critical concerns of the IAG were primarily that a revised investment strategy should seek to provide a reduction in investment return volatility, following the asset valuation falls seen in late 2008 and early 2009.
  - 4 It should be noted that currently, the expected return (based on best estimate assumptions) on the Fund's assets is circa 3.2% per annum over gilts. The actuary assumes an excess return on 1.6% over gilts for the purposes of the actuarial valuation.

### **Revised Strategy**

- 5 Mercer has been commissioned to undertake an investment review and this is included as Annex 1 to this report. Mercer will present at the meeting of 14 February 2014 and managers from Axa Investment Managers will provide associated training.

### **Liability Driven Investment**

- 6 Mercer has recommended that the Fund establish a liability driven investment strategy (LDI) portfolio.
- 7 LDI is an investment style that seeks to match the movements in the value of a Fund's liabilities with a basket of investments whose value will be affected by prevailing bond yields in exactly the same way as the value of the Fund's liabilities. Due to the historic low yields at present, an attempt to match all of the Fund's liabilities would be considered expensive; however, the decision to match a scheme's inflation-linked liabilities is much more attractive, especially for the LGPS as there are direct inflation linkages to the pension liabilities.
- 8 Despite the current low yields and the resultant expensive switch, Mercer's advice is that it is time to set up such a LDI structure, given the level of training and due diligence required (nine to twelve months is a reasonable expectation), so looking at this now could put the Fund in a better position where it could react relatively swiftly to capture what would be considered attractive future de-risking opportunities. Without the appropriate structure in place, the opportunity to de-risk when opportune could easily be missed.

### **Infrastructure Debt**

- 9 There are clear benefits for LGPS funds to take on infrastructure investments with the potential to offer stable, transparent and inflation-linked cashflows in order to address the inflation-indexed liabilities of the fund.

- 10 There will be an emphasis on putting the platform in first with a view to building up the allocation over time, based on funding improvements and also as real yields increase.

#### **Diversified Growth Funds**

- 11 Further venture into DGF will assist with further return diversification and improved risk management.

#### **CONSULTATION:**

- 12 The Chairman of the Pension Fund has been consulted on the revised draft and would support members being trained in order to implement such a strategy as and when needed.

#### **RISK MANAGEMENT AND IMPLICATIONS:**

- 13 The risk related issues are addressed in the Mercer report in Annex 1.

#### **FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

- 14 The financial and value for money implications are addressed within the Mercer report in Annex 1.

#### **CHIEF FINANCE OFFICER COMMENTARY**

- 15 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed, with the proviso that training needs should be addressed prior to any decisions on the implementation of the proposed strategy review recommendations. Members should be well informed and trained on the proposed structure for the way ahead and satisfied that the changes are relevant to the requirements of the Pension Fund.

#### **LEGAL IMPLICATIONS – MONITORING OFFICER**

- 16 There are no legal implications or legislative requirements associated with this report.

#### **EQUALITIES AND DIVERSITY**

- 17 The investment strategy review will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

#### **OTHER IMPLICATIONS**

- 18 There are no potential implications for council priorities and policy areas.

## **WHAT HAPPENS NEXT**

19 The following next steps are planned:

- Adoption of the principles of the investment strategy review.
- Further training provided to Board members.
- Officers implement changes required as a result of future specific Board recommendations.

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**Contact Officer:**

Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

**Consulted:**

Pension Fund Board Chairman

**Annexes:**

Revised Statement of Investment Principles

**Sources/background papers:**

None

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