

Pensions Committee

10.00 a.m., Tuesday, 17 June 2014

Investment Strategy Panel Activity

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on the activity of the Investment Strategy Panel (“the Panel”) for the year to 31 March 2014. The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013.

The focus of the Panel has been on the implementation of the investment strategies of the pension funds, and particularly on reducing volatility without sacrificing returns. The Panel has also continued to oversee the performance and asset allocation of the investments.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Investment Strategy Panel Activity

Recommendations

- 1.1 That Committee notes the activities of the Investment Strategy Panel during the financial year 2013/14.

Background

- 2.1 The purpose of this report is to provide an update on the activity of the Investment Strategy Panel for the year to 31 March 2014.
- 2.2 The Investment Strategy Panel (“the Panel”) currently comprises four officers (the Director of Corporate Governance, the Investment and Pensions Service Manager, the Investment Manager and the Pensions and Accounting Manager) and three investment consultants (KPMG, represented by David O’Hara, and two independent advisors, Gordon Bagot and Scott Jamieson).
- 2.3 The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013.

Main report

- 3.1 The Panel meets quarterly and considers all aspects of the Funds’ investments. Regular activities include reporting to and making recommendations about investment strategy to the Committee, directing and monitoring strategy implementation and risk and advising the Director of Corporate Governance on investment structure and managers.
- 3.2 In addition to the regular agenda, at each meeting the Panel also considers special items. The primary focus for the Panel during 2013/14 has been the implementation of the investment strategies for all three pension funds agreed by Pensions Committee in October 2012. This has involved:
 - Detailed reviews and analysis of the internal team’s research into complementary equity strategies that will produce improved and appropriate risk-adjusted returns;
 - Analysis of the impact of new strategies on the overall equities of the funds;
 - Agreeing the benchmark indices and performance targets of individual mandates including restructuring of the index-linked asset portfolio to align it better with the Fund objectives;

- A review of bond manager strategies, outlook for bond returns and an assessment of the Lothian Pension Fund's existing bond mandate;
- Establishing the timetables for the change of strategies,
- Analysis of the transitions of assets.

3.3 Other special items considered during 2013/14 included:

- Cashflow projections for unlisted assets;
- A review of the Funds' investment mandates, including objectives and controls for suitability;
- The review of investment operations conducted by an external independent consultant;
- Alternative funding approaches for the Scottish Homes Pension Fund;
- Draft Statement of Investment Principles;
- Review of Panel effectiveness.

3.4 Panel's reviews and decisions have resulted in:

- Progress of the implementation of the pension funds' investment strategies, as detailed elsewhere on the agenda;
- Reduced expected volatility in the equity portfolios of Lothian Pension Fund and the Lothian Buses Pension Fund;
- Mandates for each of the investment portfolios including objectives and controls;
- Indicative timescales for further implementation of the investment strategies.

3.5 A key area of the Panel's remit is the monitoring and assessment of the Funds' investment performance and its investment risk, both for each overall fund, but also for each investment mandate. During 2013/14, the internal team, working with the Funds' independent performance measurer and Panel, has spent time considering the most effective ways of ensuring that the Funds and their managers are taking the appropriate risk so that the Funds achieve their objectives over the long term. The aim is to introduce new performance indicators that will be useful tools to measure and demonstrate volatility of investment performance. These will be introduced as the investment strategy matures and performance history of the investment strategy is established.

3.6 Over 2014/15, the Investment Strategy Panel will focus on:

- implementation of the strategy for the three Funds, including changes to the actual allocations at the asset class level and potential changes to the structure within asset classes;
- continuing to scrutinise the management of the individual portfolios, potentially involving further rationalisation and mandate changes;
- continuing to explore other suitable alternative investment opportunities;
- exploring alternative funding approaches for the Scottish Homes Pension Fund and other conclusions resulting from the 2014 actuarial valuation.

- 3.7 Importantly, the focus of the Panel is the long term asset returns of the Funds rather than the short term vacillations of the investment markets, and deploying the Funds' long term capital at an appropriate level of risk.

Measures of success

- 4.1 The investment performance of the pension funds is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investments are:
- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
 - Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Financial impact

- 5.1 This report details the investment activities of the Investment Strategy Panel. The investment performance of the three Funds has a significant impact on the funding levels and potentially on the contributions required from employers.

Risk, policy, compliance and governance impact

- 6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates. The Funds' investment strategies are aimed at reducing the risk without sacrificing returns.

There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Director of Corporate Governance, who takes advice from the Investment Strategy Panel. The Investment Strategy Panel is an important element of the governance of the pension fund investments.

Equalities impact

- 7.1 There are no equalities implications as a result of this report.
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Sustainability impact

- 8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

- 9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

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Links

Coalition pledges

Council outcomes CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Appendices None