

Pensions Committee

10.00 a.m., Tuesday, 17 June 2014

Investment & Funding Update – Scottish Homes Pension Fund

Item number	5.9
Report number	
Executive/routine	
Wards	All

Executive summary

Over the twelve months to 31 March 2014 the Fund produced a return of 2.1%. The Fund's actuary has estimated that the Scottish Homes Pension Fund's funding level (the ratio of assets to liabilities) was 90.5% at 31 March 2014. The actuary is currently undertaking the 2014 actuarial valuation and will reassess the underlying assumptions. As reported to Committee in March 2014, a review of the funding strategy is underway.

Changes to the Fund's asset allocation agreed by the Pensions Committee in October 2012 have been implemented. Further work to reduce the risk within the Fund's equities is the outstanding element of the implementation of the strategy. Further progress will be made once discussions with the Scottish Government on funding issues ahead of the 2014 actuarial valuation are complete.

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 & Funding Update – Scottish Homes Pension Fund

Recommendations

- 1.1 That the Pensions Committee notes the performance, funding level and asset allocation of the Scottish Homes Pension Fund.

Background

- 2.1 The purpose of this report is to provide an update on the investments and funding level of the Scottish Homes Pension Fund to 31 March 2014.
- 2.2 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.

Main report

Investment Performance to 31 March 2014

- 3.1 The Fund's objectives agreed by Committee in December 2012 are:
- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the benchmark;
 - Over shorter periods, the Fund should perform better than the benchmark if markets fall significantly.
- 3.2 The Fund's annualised performance over the year and longer-term periods is shown in the table below. The Fund has performed in line with its benchmark over all timeframes. The Fund's equity and bond assets have been managed passively since Q4 2010.

% per annum	1 Year	3 Years	Since Inception (July 2005)
Scottish Homes Pension Fund	+2.1	+9.1	+8.0
Benchmark	+2.1	+9.1	+8.0
Relative	+0.0	+0.0	+0.0

- 3.3 Over the year to 31 March 2014, the Fund's volatility was similar to that of the benchmark. The funding agreement and investment strategy of the Fund are being reviewed to explore alternative funding approaches.

Funding Level

- 3.4 The funding level (ratio of assets to liabilities) and its position relative to its target (as specified in the funding agreement with the Scottish Government) are monitored quarterly by both the Fund's actuary and the Investment Strategy Panel.
- 3.5 The actuary has estimated a funding level of 90.5% as at 31 March 2014, which means that assets are insufficient to meet liabilities based on the assumptions made. The position has improved from 86.2% at the date of the last actuarial valuation on 31 March 2011. Healthy returns from the Fund's assets over the 3 year period have been partially offset by a decline in real gilt yields, which has caused an increase in the value of liabilities.
- 3.6 Over the same period, the target funding level has increased from 89.5% to 91.5%. (Under the agreement with the Scottish Government, the target funding level increases gradually over time to reach 100% by 2044). The shortfall of the funding level relative to target has therefore decreased over the three year period since the last actuarial valuation due to strong investment returns over the period.
- 3.7 As reported to Committee in March 2014, Scottish Government has indicated their willingness to review the funding strategy. Options to potentially reduce the impact of short term market movements on contributions and reduce the likelihood (and size) of further contributions being required from Scottish Government are being explored. The conclusions of the review and the 2014 actuarial valuation will be considered by Pensions Committee by March 2015 at the latest.

Investment Strategy and Asset Allocation

- 3.8 Pensions Committee approved the Investment Strategy 2012-17 in October 2012. The investment strategy is set at the broad asset class level of equities, bonds and property, which are the key determinants of investment risk and return. The strategy reduces the allocation to equities and property and increases the allocation to bonds.
- 3.9 The funding agreement with the Scottish Government and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time. They allow for acceleration

in the sale of equities and property and purchase of bonds if the actual funding level improves to the target funding level.

- 3.10 Over 2013/14, the actual funding level moved closer to the target funding level and so the move to the long term strategy was accelerated. Two changes to the strategy allocation were made during the year and these are shown in the table below. The current strategy allocation is now in line with the long term strategy for Scottish Homes Pension Fund.

Scottish Homes Pension Fund - Evolution of Strategy 2013/14				
Asset Class	Strategy Allocation 31 March 2013 %	Strategy Allocation 1 September 2013 %	Strategy Allocation 29 November 2013 %	Long Term Strategy Allocation 2012-17 %
Equities	40	35	30	30
Bonds	50	60	65	65
Property	10	5	5	5
Cash	0	0	0	0
TOTAL	100	100	100	

- 3.11 The changes to the Fund's equity and bond allocations were made within the mandate managed by State Street. Holdings in the Standard Life Property pooled fund were sold at the end of August 2013.
- 3.12 Over the year assets are withdrawn from the investment manager(s) to pay pensions (approximately £650,000 per month).
- 3.13 Further work to reduce the risk within the Fund's equities is the outstanding element of the implementation of the strategy. This has been put on hold pending the review of the funding agreement (noted above). Further progress will be made once discussions with the Scottish Government are complete and when any change to the funding agreement is agreed.
- 3.14 The Fund's actual allocation to each manager and asset class at 31 March 2014 is shown in the table below, together with the long term strategy.

Asset Class	Manager	Actual Allocation 31 March 2014 %	Long Term Strategy Allocation 2012-17 %	Permitted Ranges %
Equities				
UK	State Street	6.6		
US	State Street	9.4		
Europe Ex-UK	State Street	6.1		
Asia Pacific	State Street	2.4		
Japan	State Street	3.1		
Emerging Markets	State Street	2.3		
Subtotal		29.9	30	20 - 35
Bonds				
Index-linked gilts	State Street	52.0		
Fixed income gilts	State Street	13.0		
Sub total		64.9	65	60 - 75
Property				
Property	Schroders	5.2		
Sub total		5.2	5	0 - 10
Cash		0.0	0	0 - 5
TOTAL		100.0	100	

Conclusions

- 3.15 The absolute performance of Scottish Homes Pension Fund is positive over the 12 month period to 31 March 2014 with a return of +2.1%. Three year performance is 9.1% per annum.
- 3.16 The returns for Scottish Homes Pension Fund over one and three years and since inception to 31 March 20134 are in-line with the benchmark.
- 3.17 Funding levels are monitored by the Fund actuary and Investment Strategy Panel quarterly. The estimated actual funding level at 31 March 2014 was 90.5%, below the target funding level of 91.5%.
- 3.18 The funding agreement and investment strategy of the Fund are being reviewed to explore alternative funding approaches to the current mark-to-market approach.

Measures of success

- 4.1 The investment performance of the 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 performance and funding level of the Scottish Homes Pension Fund. The investment performance has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.

Risk, policy, compliance and governance impact

- 6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates.

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 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.

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. There is a dedicated place on the Consultative Panel for the Scottish Government.

Background reading / external references

None

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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