

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Investment Strategy Panel Activity

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| Item number | 5.8 |
| 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 2015. The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2014.

The focus of the Panel has been on the implementation of the investment strategies of the three pension funds. Panel and the internal team have focused on restructuring and reducing the equity asset exposure, increasing the allocation to alternative investments, researching available bond-related products and restructuring the Other Bond portfolio, reviewing currency hedging policy and de-risking the Scottish Homes Pension Fund. The Panel also continues to oversee the performance and asset allocation of the investments.

Links

Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

Investment Strategy Panel Activity

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That Committee notes the activities of the Investment Strategy Panel during the financial year 2014/15.

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 2015.
- 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 Fund’s 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 The Panel considers the appropriate investment management structure required to implement the Fund’s investment strategy and on the process for the appointment and monitoring of external investment managers. In addition, it is responsible for setting objectives and restrictions for internally managed portfolios. It monitors the risk and performance of all portfolios. Panel and the internal investment team monitor all managers on a regular basis using a traffic light system to ensure that scrutiny of portfolios is robust. Performance, continuity of investment process, philosophy, people and ownership, are considered in the monitoring process. Where there are concerns over a

manager, more regular and in-depth monitoring is undertaken. The traffic light monitoring was reviewed during 2014/15.

3.3 In addition to the regular agenda, at each meeting the Panel also considers special items. The primary focus for the Panel during 2014/15 has been the implementation of the investment strategies for all three pension funds agreed by Pensions Committee in October 2012 and the revised strategy for Scottish Homes Pension Fund, which was agreed by Pensions Committee in December 2014. This has involved:

- Detailed reviews and analysis of the internal team's research into complementary equity, bond and alternative investments that will produce improved and appropriate risk-adjusted returns;
- Oversight of internal portfolio management, including regular in-depth review of mandates. Internal mandates are subject to periodic scrutiny to assess whether they have achieved their objectives and to ensure the premise of the mandate remains sound. Where applicable, this includes external comparisons;
- Analysis of the impact of new strategies on the overall equities of the funds;
- Reviewing Fund objectives, benchmark indices and performance targets of individual mandates to ensure portfolios and their managers are aligned with the Fund objectives;
- Agreeing investment constraints for fund investments and benchmark allocation for Other Bonds;
- Analysis and oversight of the transitions of assets;

3.4 Other special items considered during 2014/15 included:

- Cash flow projections for unlisted assets;
- Review of currency hedging policy;
- Review of bond research;
- Review of AVCs;
- Draft Statement of Investment Principles;
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3.5 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 for Lothian Pension Fund and the Lothian Buses Pension Fund;
- Reduced funding level volatility for the Scottish Homes Pension Fund;
- Changes to the composition of the funds' bond holdings;
- A new internally managed global equity portfolio;
- Updated mandates for each of the investment portfolios including objectives and controls;

- Indicative timescales for further implementation of the investment strategies.
- 3.6 Each year, the Panel undertakes a self-assessment to review its effectiveness. The self-assessment in June 2014 resulted in the review of the mandate traffic lights (noted above) and the attendance of an independent adviser at the quarterly review meetings of internal mandates. The self-assessment in 2015 has highlighted the need for the Fund to ensure there is sufficient resource allocated to the Fund's bond investment which is expected to increase as the strategy is implemented further. In addition, Panel will also review the investment management costs in detail and will consider having a special meeting to review strategies later in the year.
- 3.7 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 2014/15, 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. This has included consideration of the most appropriate benchmark indices for individual mandates and specifically the suitability of that used for Alternative investments (Retail Price Inflation +3.5%p.a.). This review is continuing and its conclusion will be reported to Committee in due course.
- 3.8 The Panel has introduced new performance indicators that are useful tools to measure and demonstrate volatility of investment performance including analysis of relative performance for months when markets deliver positive and negative performance. Panel continues to review appropriate ways to demonstrate effectiveness of the investment strategy as it matures and the performance history is established.
- 3.9 Over 2015/16, 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;
 - undertaking an investment strategy review for Lothian Buses Pension Fund.
- 3.10 Importantly, the focus of the Panel is the long term superior asset returns of the Funds rather than the short term vacillations of the investment markets, but deploying each Fund's 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 employers' 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.
- 6.2 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. In addition, active engagement with the companies in which the Fund invests should reduce risk Fund and enhance the sustainability of investment performance.

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 Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

None

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Links

Coalition pledges

Council outcomes CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

Single Outcome Agreement

Appendices None