Agenda Item No: **8**

CITY OF WOLVERHAMPTON COUNCIL

Pensions Committee

23 September 2015

Report title	SIAB Annual Review	
Originating service	Pension Services	
Accountable employee(s)	Mark Chaloner Tel Email	Assistant Director, Investments 01902 552094 mark.chaloner@wolverhampton.gov.uk
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Recommendation(s) for action or decision:

The Committee is recommended to:

1. Make the following benchmark changes
   a) For private equity, to the FTSE All World plus 2% per annum (from the FTSE All World).
   b) For emerging market debt, to a 50/50 combination of the JP Morgan EMBI Global Diversified index and the JP Morgan GBI EM Global Diversified index (from the JP Morgan EMBI Global Diversified index).
   c) For indirect property, to CPI plus 6% per annum (from the IPD UK annual property benchmark).
   d) For real assets and infrastructure, to CPI plus 4% per annum (from one month £ LIBOR).
   e) For absolute return, to one month LIBOR plus 3% per annum for insurance linked and 4% per annum from special opportunities (from one month £ LIBOR).

2. Agree that the SIAB allocation to cash is increased to 2% from 1% with a corresponding decrease in the allocation to conventional gilts from 3% to 2%.

Recommendations for noting:

The Committee is asked to note:

1. The annual SIAB review by Hymans Robertson.

1.0 Purpose

1.1 To review the Fund's investment strategy.

2.0 Background

2.1 The Fund's SIAB is reviewed annually and this year's review focusses on benchmarks and performance targets. The proposals contained in this note have been considered by the Investment Advisory Panel (IAP) at its meeting on 20 July 2015 and a detailed review by Hymans Robertson, the Fund's investment consultant, is attached in Appendix B.

2.2 Ahead of the 2016 Actuarial Valuation, it is proposed that the Fund continues to have a 90 / 10 allocation to growth and stabilising assets. At this stage no major changes are proposed in asset allocation other than to the allocations in cash and conventional gilts (as covered in 4.8 below).

3.0 Benchmarks and performance targets

3.1 Benchmarks are designed to define the target returns expected from a given portfolio segment and help in the assessment of whether a given strategy is appropriate for its intended purpose. They are also used as comparators to test the performances of investment managers. The Fund's SIAB should be capable of generating returns which, with the agreed contribution strategy, will meet the stated funding objective.

3.2 Performance targets are set for portfolio segments and / or mandates so that a return ahead of a given benchmark can be delivered. Such targets are set up for actively managed mandates in liquid asset classes where the prospect of value added is realistic (such as quoted global equities). In other areas, passive index tracking management is deployed. In many areas, alternative investments in particular, the absence of a suitable market index means that benchmarks are set with a target return derived from cash or inflation plus a premium. In such cases, no value added above the benchmark will be targeted.

3.3 In WMPF's case, outperformance of 1.0% per annum over rolling three year periods is targeted over the customised benchmark for the Fund (a composite of benchmarks for individual portfolios). This will be challenging for the Fund consistently to deliver.

4.0 Review of asset classes and proposed changes

4.1 **Quoted equities**. Hymans Robertson conducted a detailed review of the Fund's quoted equities allocation in 2014. Earlier this year, a major reorganisation of the Fund's regional quoted equities allocations was carried out and a new in-house active global equities mandate was set up. The benchmarks used in the part of this portfolio are the relevant FTSE stock market indices and it is not proposed that any of them are changed. Performance targets for emerging markets equities (at 3% per annum over the benchmark) and global equities (2%) will also be maintained. Hymans Robertson's suggestion that the performance of the Fund's quoted equities should be monitored against the FTSE All World index is a fair one and this will be done annually with the review of the Fund's performance for the financial year.

4.2 **Private equity**. The Fund currently has the FTSE All World index as the benchmark for this portfolio, reflecting its broadly based international exposure. The target return for this portfolio is 4% per annum over the benchmark. Half of that reflects the illiquidity premium expected and half the contribution from active management. It is proposed that in future, the benchmark is modified to include the 2% illiquidity premium – so that it will be the FTSE All World plus 2% per annum – with a further 2% performance target (from active management).

4.3 **Fixed interest**. For **the stabilising segment**, FTSE gilts indices are used for this segment and no changes are proposed. These allocations will continue to be managed passively. For cash, the current benchmark, one week £ LIBID, remains appropriate For **the return seeking segment**, the one change proposed at this stage is a revision to the emerging markets debt (EMD) benchmark. The current benchmark (the JP Morgan EMBI Global Diversified index) is based on US dollar sovereign bonds only. In recent years the EMD universe has changed to include local currency and corporate bond issues. Looking ahead, it is important for the Fund to have exposure across a wide range of EMD markets, including local currency issues. Accordingly it is proposed that the EMD benchmark is modified to a 50/50 blend of the JP Morgan EMBI Global Diversified index (the existing benchmark) and the JP Morgan GBI-EM Global Diversified index (which is a local currency index). The performance target should remain at 3% per annum ahead of the benchmark. Pending the reorganisation of the return seeking fixed interest portfolio with a new multi credit strategy mandate, it is not proposed that any changes are made to the corporate bond and other fixed interest benchmarks.

4.4 For **the cashflow matching allocation** in respect of orphan liabilities, it is proposed that a benchmark of the FTSE UK gilts all stocks index plus 1.4% per annum is adopted, in line with the required return for this segment (as advised by Mercer). This allocation will be set up with effect from 1 October 2015.

4.5 **Alternative investments**. For **the directly managed property portfolio**, it is proposed that the benchmark remains the IPD UK annual property benchmark (with IPD's quarterly property index used for quarterly performance monitoring). A 1% per annum performance target was agreed with CBRE with the commencement of its revised mandate in October 2014 and no change is proposed. Following discussions with the IAP and Hymans Robertson, it is proposed that the benchmark for **the indirect property portfolio** is modified to CPI plus 6% per annum. An inflation linked target is appropriate for this segment along with a premium to reflect its illiquidity and risk characteristics.

4.6 For **real assets and infrastructure**, the current benchmark – one month £ LIBOR – is clearly not appropriate. By investing in these areas, the Fund is looking for an inflation linked return plus a premium similar to that available from quoted equities. Accordingly it is proposed that the benchmark is changed to CPI plus 4% per annum.

4.7 In **the absolute return segment**, there are two components, insurance linked and special opportunities. Currently these are benchmarked against one month £ LIBOR and it is proposed that the benchmark is modified to include a premium of 3% per annum for insurance linked and 4% per annum for special opportunities, as recommended by both the IAP and Hymans Robertson.

4.8 **SIAB allocation change**. The Fund's allocation to cash has been running at higher levels – typically 5%- than the SIAB allocation at 1%. With major portfolio reorganisations, distributions and net contribution inflows, cash inflows have been strong. In recent months, investments have been made in quoted equities during periods of market weakness and selectively in other areas. There are plans to invest capital during the final quarter of 2015, too. To allow for greater flexibility in the future, it is proposed that the SIAB allocation to cash is increased to 2% from 1% and the allocation to conventional gilts is correspondingly reduced to 2% from 3%.

4.9 **Timing**. It is proposed that all of the proposed changes are made with effect from 1 October 2015.

4.10 A table setting out the proposed SIAB, benchmarks and performance targets is set out in Appendix A.

5.0 Financial implications

5.1 These are detailed throughout the report.

6.0 Legal implications

6.1 This report contains no direct legal implications.

7.0 Equalities implications

7.1 This report contains no equal opportunities implications.

8.0 Environmental implications

8.1 This report contains no environmental implications.

9.0 Human resources implications

9.1 This report contains no direct human resources implications.

10.0 Corporate landlord implications

10.1 This report contains no direct corporate landlord implications.

11.0 Schedule of background papers

11.1 None

12.0 Schedule of Appendices

12.1 Appendix A - Proposed SIAB, benchmarks and performance targets.

12.2 Appendix B - SIAB Annual Review by Hymans Robertson.