Agenda Item No. 11

Pensions Committee

24 September 2014

Report title	SIAB Annual Review	
Originating service	Pension Services	
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Recommendation(s) for action or decision:

The Committee is recommended to approve the following changes in the SIAB asset allocation with effect from 1 October 2014 –

1. An increase in the allocation to property to 10% of assets (from 9%), with a 7% allocation to direct property (up from 6%) and a 3% allocation to indirect property.
2. The creation of an allocation to real assets and infrastructure, with a target allocation of 6% (compared with the current 4% allocation to infrastructure) and for the allocation to agriculture funds (0.2% and currently in the commodities portfolio) to be transferred to this segment.
3. The elimination of the allocation to hedge funds (3%).
4. In the stabilising segment of the fixed interest portfolio, for an increase in the allocation to index linked gilts to be increased to 6% (from 5%) and for a corresponding decrease in the allocation to conventional gilts (to 3% from 4%).

The Committee is also invited to endorse the asset transfer arrangements for the Ministry of Justice (MoJ) Probation Trust pensions, for which Greater Manchester Pension Fund is assuming responsibility. It is estimated that the Fund will transfer £235 million of assets in the final quarter of 2014, with funding from cash resources (£175 million) and the balance from the transfer of the Fund's holding in a short dated UK gilt fund (£60 million).

Recommendations for noting:

The Committee is asked to note Hymans Robertson's SIAB annual review. It is planned that a statement of investment beliefs will be presented to the Committee's next meeting.

1.0 Purpose

1.1 To review the Fund's investment strategy and recommend changes to the Strategic Investment Allocation Benchmark (SIAB).

2.0 Background

2.1 At its meeting in June 2014, the Investment Advisory Sub-Committee received an investment strategy review, the key finding of which was that the current investment strategy, with a 90% allocation to 'growth assets' and a 10% allocation to 'stabilising assets' remained appropriate for the Fund.

2.2 The SIAB annual review looks at the Fund's asset allocation in greater detail and makes specific recommendations for the Committee's consideration. Hymans Robertson will make a presentation to the Committee and attached to this paper is a note setting out their views.

3.0 General considerations regarding the Fund

3.1 The Fund has a well diversified portfolio with exposure to a wide range of asset classes and managers. However, exposure to equities (58% in total including private equity) remains very substantial and equity related risks continue to dominate, as highlighted in Hymans Robertson's report.

3.2 Governance is important. The Fund continues to have a very large number of mandates and it is suggested that the process of simplifying the portfolio's management arrangements continues. The number of mandates should be further reduced and it is suggested that this can be done without affecting the Fund's favourable diversification characteristics. There are several advantages to having simpler management arrangements –

- Tighter monitoring and oversight of portfolios
- Facilitating the setting of portfolio objectives and portfolio construction (creating portfolios with more clearly defined characteristics)
- Facilitating asset allocation changes in the future – these will be needed as the Fund's liability profile changes
- Making the process of setting up and managing employer specific investment strategies more straight forward

3.3 The Fund has substantial exposure to illiquid assets (30% accessible after three months or longer). This makes sense for long term investors so that they can take advantage of the full investment opportunity set and also exploit the relative inefficiencies of illiquid markets as well as the attractive returns available from them. Because the Fund remains relatively immature and continues to generate cash (from income and net contributions) it is suggested that the Fund continues to have a material exposure to illiquid assets but that the proportion invested in this area should not rise above 40% and that this limit is reviewed annually.

3.4 It is important also to look at the prevailing market environment. Major liquid asset classes in developed markets – listed equities and fixed interest – have performed very strongly over the past five years (most developed country stock markets have nearly doubled since March 2009). This reflects the policy decisions taken by the authorities in the wake of the credit crunch (which led to huge injections of liquidity into markets) as well as economic recovery and far greater confidence in the outlook. We agree with Hymans Robertson's assessment that valuations in most liquid developed markets look full and that from current levels, prospective returns are likely to be low compared with the experience since March 2009.

3.5 Other asset classes, including illiquid areas like property and fixed interest, offer some value in specific areas but in general are not obviously undervalued in the way that they were in the wake of the credit crunch. It is against this background that changes in the SIAB are proposed and the next section will cover the key asset classes in turn.

3.6 Finally, it is important that the Committee has conviction in the investment philosophy adopted by the Fund and in that regard, it is suggested that a statement of investment beliefs is adopted. It is proposed that this will be considered in the first instance at the trustee training session planned for October in Edinburgh and then presented to the Committee at its next meeting.

4.0 Review of asset classes and proposed SIAB changes

4.1 **Listed equities**. This year's detailed SIAB review by Hymans Robertson covers listed equities and will be presented to the Investment Advisory Sub-Committee on 24 September. At this stage, it is suggested that the overall allocation to listed equities (48%) is not changed but within the overall structure, there will be a higher allocation to global equities and less in UK equities. Further simplification of the mandate structure will be proposed with detailed proposals planned for the Pensions Committee's next meeting (which takes place in December 2014).

4.2 **Private equity.** The amount invested in this area (12%) is well above the target allocation at 10%. With the maturing of the existing portfolio and assuming a favourable market environment, net distributions should lead to a reduction in exposure to target by the end of 2016. In the meantime, new contributions will be made very selectively (with a ceiling of £150 million in the current year).

4.3 **Fixed interest.** In the stabilising segment of this portfolio (10%), it is suggested that the SIAB allocation to index linked gilts is increased to 6% (from 5%) and that the allocation to conventional gilts is lowered to 3% (from 4%), reflecting our view that at this stage we should be more concerned about protecting the portfolio from future inflation. This change would bring the actual allocations more closely into line with the SIAB. Proposals for the simplification of the return seeking segment of the fixed interest portfolio will be presented to the Committee. In the meantime, no changes in allocations to or within this area are proposed.

4.4 **Alternative investments.** Although property markets have recovered since the credit crunch, there remains some value in this area and it is suggested that the allocation to property is increased to 10% (from 9%) with a 7% target allocation to direct property (from 6%) and 3% to indirect property (unchanged). CBRE has been reappointed to manage the Fund's direct property holdings and will be given latitude to increase exposure in the coming year.

4.5 With the elimination of the Fund's exposure to commodities funds, it is suggested that a new investment segment is created, to be called 'real assets and infrastructure.' This will combine the Fund's allocation to infrastructure (for which there is a target allocation of 4%) and other real assets, which at present are represented solely by two agriculture funds (accounting for 0.2% of assets). It is proposed that the allocation to this segment is set at 6% but fully recognised that patience is needed to identify and access top quality opportunities in this area on suitably attractive terms, so achieving this level of exposure will take time (current exposure is 3.3%).

4.6 It is also proposed that the allocation to hedge funds, currently 3%, is eliminated. The Fund's current exposure, accounting for 2.1%, has to date delivered mediocre returns net of (very high) fees and it is open to question whether they will have a useful role to play in the portfolio in the future. Hedge funds are also a complex area to monitor and from a governance perspective, tie up substantially more resources than their weight in the portfolio warrants. Other changes planned for the portfolio will be designed to reduce portfolio volatility, removing the need to invest in this area. It is planned that (as with commodities), there will be a phased exit from hedge funds and that the Fund's exposure will be eliminated by the end of 2015 (one fund has a lock up period which comes to an end then).

5.0 MoJ Probation Trust pensions asset transfer

5.1 Greater Manchester Pension Fund (GMPF) is assuming responsibility for the MoJ Probation Trust pension fund arrangements and as part of the transition, other LGPS funds, including WMPF, will transfer their share of the relevant assets in the final quarter of 2014. It is estimated, subject to final confirmation from the actuaries, that WMPF will transfer £235 million then. It has been agreed that the transfer will be funded from cash resources (£175 million) with the balance (£60 million) from the transfer of the Fund's holding in the passively managed short dated UK gilts fund managed by Legal & General. The Committee is invited to endorse the funding arrangements for the forthcoming transfer, which will be made on a phased basis in October and November 2014.

6.0 Financial implications

6.1 This report contains no direct financial implications.

7.0 Legal implications

7.1 This report contains no direct legal implications.

8.0 Equalities implications

8.1 This report contains no direct equalities implications.

9.0 Environmental implications

9.1 This report contains no direct environmental implications.

10.0 Human resources implications

10.1 This report contains no direct human resources implications.

11.0 Corporate landlord implications

11.1 This report contains no direct corporate landlord implications.

12.0 Schedule of background papers

12.1 There were no preceding background papers.

13.0 Appendices

13.1 Appendix 1: SIAB annual review, September 2014