Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES		
Investment Strategy – De-Risking Framework **Pensions Committee** **21st March 2018**	**Classification** **NONE** **Ward(s) affected** **ALL**	**Enclosures** **One** .

1. INTRODUCTION

1.1 This report sets out a proposal for the Fund to introduce a set of updated de-risking triggers. The report follows on from the investment strategy modelling work undertaken by the Fund's investment consultants following the 2016 valuation, and takes into account the changes to the Fund's investment strategy recommended as part of that work.

2. RECOMMENDATIONS

2.1 The Committee is recommended to consider and approve:

- **Setting de-risking triggers for the Fund, i.e. 88% now, increasing to 89.5% from 1/1/19 and to 91% from 1/1/20**
- **The principle of regular review of triggers;**
- **The process for implementing changes to the Fund asset allocation should the trigger level be breached, i.e. report to the Chair and Group Director, Finance and Corporate Resources for approval; and**
- **Delegate responsibility for reviewing the transition management arrangement for the Fund to ensure efficient implementation to the Officers, in liaison with the Chair of the Committee.**

3. RELATED DECISIONS

3.1 Pensions Committee 29th March 2017 – Investment Strategy

4. COMMENTS OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES

4.1 The Pensions Committee's governance role requires it to ensure there are realistic strategies in place to meet funding goal and that strategies are affordable, prudent and provide stability for employers in the Fund. The modelling work carried out for this report provides comfort that there is a high probability of success in achieving a fully funded position for the Fund under a range of scenarios. There may be scope to change the risk profile of the Fund to enable it to adopt an investment strategy that is less reliant on growth assets.

4.2 There are no immediate financial implications arising from this report

5. COMMENTS OF THE INTERIM DIRECTOR, LEGAL

5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 charge administering authorities with determining the appropriate mix of investments for their funds.

5.2 The Committee therefore has legal responsibilities for the prudent and effective stewardship of the Pension Fund and a clear fiduciary duty in the performance of its functions. Reviewing the Fund's Investment Strategy and its implementation helps to ensure that the Strategy remains appropriate given the funding position and assists the Committee in fulfilling this duty.

5.3 There are no immediate legal implications arising from this report.

6. INVESTMENT STRATEGY AND DE-RISKING TRIGGERS

6.1 Appendix 1 to this report sets out the arrangements for a framework to set in place de-risking triggers for the Fund and the implementation process should the trigger points be met. This follows on from work considered at a number of Committee meetings over the past 18 months. Like the initial investment strategy work, the framework has been developed by the Fund's investment consultant, Hymans Robertson.

6.2 The most recent valuation, in 2016, showed the Fund to be 77% funded, with an estimated monetary deficit of £350m. This had improved to 83% by 31st December 2017, assuming a roll-forward of the valuation assumptions. Given that the benefit structure of the scheme is set nationally, this funding gap can only be closed by asset outperformance or by increasing contribution payments.

6.3 The Committee has a current strategic benchmark allocation of 83% in growth assets although has previously agreed to change the composition of this strategy. As the funding level improves, the requirement to hold growth assets will reduce and there may be a desire to reduce investment risk from current levels. One way to achieve this is to reduce risk at times when the funding position is ahead of expectations, effectively capturing positive performance and taking the opportunity to crystallise gains.

6.5 At the Pensions Committee meeting on 29th March, changes to the investment strategy were agreed that would shift 10% of Fund assets from equity to liquid and illiquid debt, increasing the proportion of income generating assets. The work undertaken by Hymans on the de-risking triggers suggests that implementing this change at the current funding level will increase the funding level in the 5% of worst outcomes, i.e. reduce downside risk, whilst the probability of success in 2031 remains broadly similar. The report therefore suggests that implementation of this change should proceed as planned.

6.6 In the very long term, the Committee is targeting a funding position in excess of 100% on a gilts basis and being invested with less risk relative to the liabilities of the Fund. In the "shorter term" the target is for the Fund to be 100% funded on gilts +1.65% basis by 2031. The investment strategy should be set and developed to achieve that target. If the funding position is strong enough, it may be possible to reduce the Fund's holding in growth assets as the return required in order to achieve the desired funding level is reduced. As a result the Fund can afford to de-risk and have a higher allocation to more defensive assets including gilts and high quality corporate bonds.

6.7 Hymans' analysis considers initial triggers that could be adopted to retain a c70% chance of achieving the longer term objective, within the constraints of practicality and simplicity, based on changes in funding level and the reflecting the time factor. The analysis suggests that a funding level of 88% today would allow a 73% growth/income strategy to be adopted and retain a c70% chance of achieving full funding on a gilts +1.65% basis in 2031. To ensure the trigger has some validity over time, the analysis is extended to indicate the levels over the next two years, building in the principle that the funding level would be expected to improve over time, even if just on track for a given strategy.

7. IMPLEMENTATION

7.1 If the funding level improves as a result of asset outperformance (versus expected) the source of that improvement can be targeted in the de-risking plans e.g. if the reason for the improvement was rising real yields then the Committee may wish to increase the allocation to bonds via the BMO mandate or perhaps consider an alternative bond mandate. If the improvement is predominantly driven by strong equity markets and bond yields remained broadly unchanged it may not be the ideal time to increase the Fund's allocation to bonds. As a result an increased allocation to Invesco/GMO or a new absolute return mandate would be preferable as a means to diversify the Fund's growth exposure.

7.2 In the event a trigger level is reached, Hymans will prepare a short paper covering, but not limited to the following areas/questions:

- The date the trigger was reached.
- What drove the improvement in funding level? What has the impact been on the deficit?
- How have markets moved since the date of the update? Have there been any material moves in equity or bond markets that may have significantly affected the position at the reporting date?
- What action is recommended? Diversifying the growth assets? Increasing the Fund allocation to matching assets? Are there any new asset classes which should be considered?
- Implementation. Should a transition manager be used? Can the CIV facilitate implementation? Are futures the most efficient and timely fashion to implement over the short term to ensure that the opportunity is not missed? Is a further procurement process required?

7.3 Once each of these areas has been considered, the summary paper will be sent to the Committee Chair and Group Director, Finance and Corporate Resources for approval prior to implementation. If approval is given the Officers and Hymans Robertson LLP will work together to implement as soon as reasonably practical. A recommendation has been made for delegated responsibility, in liaison with the Chair of the Committee, in reviewing transition arrangements to ensure that decisions can be implemented within a suitable timeframe.

Appendices:

Appendix 1 – De-risking Triggers and Implementation Process

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