AGENDA ITEM 9

Essex Pension Fund Board	EPB/28/11
date: 28 September 2011	

Investment Steering Committee (ISC) Quarterly Report

Report by the Group Manager Investments
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1. Purpose of the Report

1.1 To provide a report on ISC activity since the last Board meeting.

2. Recommendations

2.1 That the Board should note the report.

3. Background

3.1 In accordance with the constitution of the Essex Pension Fund (the Fund) the ISC is required to submit quarterly reports on its activities to the Essex Pension Fund Board (the Board). Since the Board's last meeting the ISC has met once, on 27 July 2011.

4. Report of meeting of ISC on 27 July 2011

4.1 This was the annual strategy meeting. Hymans Robertson, the investment consultants, provided the ISC with a comprehensive report on the Fund performance for 2010/11.

4.2 This review, which covered both fund and individual manager performance, revealed that the Fund had enjoyed extremely good performance with an absolute return for the year to 31 March 2011 of 10%, 2.2% up on the Fund's customised benchmark. Comparisons between selected peer authorities and with the 100 funds in the WM universe were provided and these showed that Essex had been the best performing fund amongst its 6 chosen peer authorities over the year and ranked 6th in the WM comparison.

4.3 The performance of individual managers was analysed and it was reported that Hymans Robertson remained happy with the appointment of all the Fund's managers. While there were some concerns over certain aspects of 3 of the managers, it was considered that their appointments should continue. For the first time the review of the manager line-up incorporated the fee analysis recently requested by the ISC. This concluded that the Fund was paying at or slightly below average fee levels for the majority of its mandates. This was to be expected given the buying power inherent in the size of mandates and the time spent negotiating fee levels with managers.

4.4 The ISC were then provided with an update on Hymans Robertson's views on the various investment assets and analysis of the consequent implications for the future investment strategy of the Fund. This was followed by a wide ranging and informative presentation from analysts from GSAM, one of the Fund's bond managers, on the outlook for the global economy and the identification of the top 8 emerging markets (Brazil, Russia, India, China, South Korea, Mexico, Indonesia and Turkey) as "growth markets".

4.5 The ISC began its annual review of strategy and structure by considering a summary of progress, on the various matters considered at its strategy meeting in February 2011, which is set out below:

Actions	Progress	Comments
Property allocation to 15%	Ongoing	Aviva increasing gradually
Review overall property benchmark	Ongoing	Aviva have made some proposals
Timber provider selection	Ongoing	
Terminate activism	Ongoing	Largely complete – side pockets need to run off over time

Switch L&G gilts to index-linked gilts	Ongoing	Implementation process agreed and in place
Financing fund extension	Complete	85% (by value) of investors participating
Private equity commitments to continue at £50m p.a.	Complete	
Conduct asset liability study	Complete	
Switch GSAM to Libor + benchmark	Complete	Implemented mid February 2011
Research diversification of UK equities by index	Complete	Proposal to discontinue
Infrastructure commitment to direct fund	Complete	
Further research on cleantech and agriculture	Yet to start	

During discussion of this update it was agreed that:

- further diversification of passive UK equity exposure was not critical and that consideration of this would cease at the current time;
- the ISC would interview two candidates for timber manager in either Q3 or Q4 of 2011;
- further investigation of proposals for the property benchmark would be carried out by officers, in consultation with advisers, to produce a firm recommendation in either Q3 or Q4 of 2011; and
- the equity element be removed from the benchmark of both active currency managers with the detailed arrangements for implementation delegated to officers, in consultation with advisers.

4.6 After lunch the ISC reconvened to consider the asset liability study that had been undertaken by Hymans Robertson. The model used in the study showed that there was a 68% chance of the fund being more than 100% funded on the technical provisions basis after 21 years. The average of the worst 5% funding levels modelled was 39%. It was concluded that the current investment strategy is consistent with the funding objectives.

4.7 The impact of changing investment strategy was then discussed. It was highlighted that increasing the amount invested in equities from 60% to 75% in the portfolio would not (as illustrated below) increase the probability of success, but would increase risk. It was similarly emphasised that reducing equity exposure to 45%, whilst resulting in a small reduction in the probability of success (66% instead of 68%) would also significantly reduce risk. However, it was noted that reducing equity exposure to 45% resulted in the median funding after 21 years falling (132% dropping to 120%).

Investment strategy	Probability of "success"	Measure of risk	Median funding after 21 years
30% equity	60%	53%	109%
45% equity	66%	47%	120%
60% equity	68%	39%	132%
75% equity	66%	32%	136%

It was therefore agreed that:

- no changes would be made to the investment strategy at the current time;
- officers, in consultation with advisers, were to develop a medium term plan to reduce risk

4.8 Subsequent discussion considered scenarios in which the funding level of the Fund improved and the options the ISC might then have to reduce risk. The analysis looked at whether the Fund would keep contributions at present levels and reduce risk or reduce contributions and keep the same level of risk. It was considered that the Fund might well prefer to continue running the current level of risk and reduce the period over which any deficit contributions were made.

4.9 The ISC then examined current cash flow projections and noted that if the Fund's membership were to remain stable cash-flow should remain positive for 13 years until 2025. However if the number of new entrants fell the Fund could become cash-flow negative more quickly. Consideration was given to the possible impact of the Comprehensive Spending Review on Local Authority staffing levels together with the potential for increased employee contributions leading to significant numbers of staff opting out of the LGPS. Either of these scenarios could lead to an increase in the Fund's maturity and a consequent increase in the level of risk of not achieving the funding objective. It was therefore agreed that the Board should be provided with statistics on the levels of opt outs and staff replacements.

4.10 It was noted that a single investment strategy means that employers with a more mature staffing profile take more risk. One way of addressing this would be to offer an alternative investment strategy and it was agreed that the practicalities of offering an alternative investment strategy should be reviewed by officers, in consultation with advisers.

4.11 Given the possibility that the Fund could become cash-flow negative within the next 10 years, the implications for liquidity, in particular within those asset classes considered to be illiquid, had been assessed. As a result it was agreed that whilst the current programme for investments in alternative asset classes is appropriate, it would not be expanded.

5. Link to Essex Pension Fund Objectives

5.1 Investments
5.1.1 To maximise the returns from investments within reasonable risk parameters.
5.1.2 To ensure the Fund is properly managed.

6. Risk Implications

6.1 The asset liability modelling study has indicated that, while the present investment strategy remains appropriate, if membership levels fell the increasing maturity of the Fund could adversely affect cash flow and increase the risk of not achieving the funding objective. This finding, together with the mitigating actions that have been put in place, will be added to the Fund's risk register.

7. Communication Implications

7.1 The material findings from the review and the actions taken will be included in a presentation to the next Forum for fund employers.

8. Finance and Resources Implications

8.1 None other than those already identified as part of the Fund's investment strategy.

9. Background Papers

9.1 ISC meeting 27 July 2011– Agenda and minutes.