PAPER C

Purpose: For Noting

Committee report

COMMITTEE	**ISLE OF WIGHT PENSION FUND COMMITTEE**
DATE	**15 NOVEMBER 2019**
TITLE	**REBALANCING INVESTMENT PORTFOLIO**
REPORT OF	**TECHNICAL FINANCE MANAGER**

EXECUTIVE SUMMARY

1. This report sets out the process followed to implement the rebalancing of the pension fund's investment portfolio, as agreed by the Pension Fund Committee at its meeting on 17 May 2019. It also sets out the result of the rebalancing activity, including analysis of the impact of these transactions on the overall value of the fund's investments.

2. Members are asked to note the process followed and the results.

BACKGROUND

3. At its meeting on 17 May 2019, the committee received a report from Hymans Robertson stating that the fund's investment asset allocation at 31 March 2019 was out of balance with its strategic asset allocation, specifically having a much higher proportion of its assets invested in the global equity portfolio than the target suggests (known as 'overweight' to global equity).

	Value (£m)				
Manager	Q4 2018	Q1 2019	Actual Proportion %	Target Proportion %	Difference %
Majedie UK Equity	115.8	123.6	20.3	22.5	-2.2
Newton Global Equity	232.0	251.4	41.4	32.5	8.9
Baillie Gifford Diversified Growth	77.5	82.2	13.5	15.0	-1.5
Schroders Property	36.3	36.4	6.0	8.0	-2.0
Schroders Fixed Income Fund	109.2	113.6	18.7	22.0	-3.3
Total	**570.7**	**607.2**	**100.0**	**100.0**	0.0

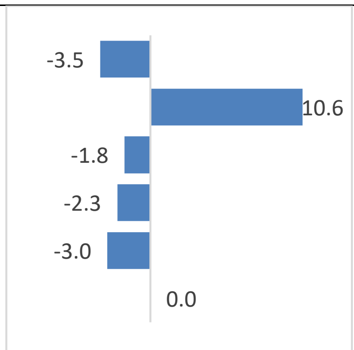
4. The maximum variation from the fund's strategic asset allocation proportions depends on the asset class involved, as set out in the Investment Strategy Statement (ISS):

Asset class	**Allocation %**	**Allowable range**
Equity	55.0	+/- 6%
Diversified growth fund	15.0	+/- 4%
Property	8.0	+/- 4%
Fixed income	22.0	+/- 4%

5. As the global equity position was significantly outside that allowable range, the recommendation at that meeting was to disinvest from the global equity portfolio and top up the UK equity and diversified growth portfolios.

6. Since 31 March 2019, the fund's portfolio has continued to grow, due to market movements, and the resulting overweight position to global equities has increased. The position at 30 September 2019 is summarised below:

Manager	**Value (£m)**	**Actual proportion %**	**Target proportion %**	**Difference**
Majedie UK Equity	123.2	19.0	22.5	
Newton Global Equity	279.0	43.1	32.5	
Baillie Gifford Diversified Growth	85.1	13.2	15.0	
Schroders Property	36.9	5.7	8.0	
Schroders Fixed Income Fund	122.9	19.0	22.0	
TOTAL	**647.1**	**100.0**	**100.0**	



7. As a result of the increased exposure to the fund to global equities at the end of September, the decision was taken to progress with the rebalancing of the fund's portfolio in line with the initial decision taken by the committee.

8. On recommendation from Hymans Robertson, £55 million was disinvested from the Link/ACCESS (Newton) global equity portfolio to reduce the overweight position.

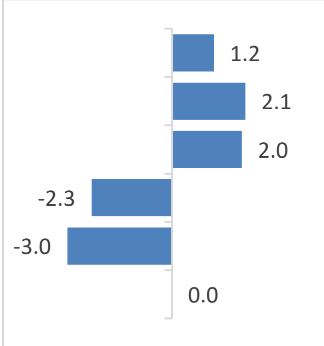
9. Consideration was given to the destination of the funds from the disinvestment of global equities, and it was determined to reinvest £30 million into Majedie UK Equity and £25 million into Baillie Gifford diversified growth fund. The other asset classes were considered and rejected for the following reasons:

- **UK property** is very illiquid (ie not easily bought or sold on the open market) and the outlook for the asset class is uncertain. There is also uncertainty as to how ACCESS will pool property assets, hence not chosen, to prevent the fund incurring excess transaction costs.

- The price of **fixed income** assets is extremely high, so would not provide good value for money at this stage.

10. This rebalancing was designed to bring all portfolios within the allowable deviation from their strategic allocation, as illustrated below.

Manager	Est. value **(£m)	Rebalanced proportion ** %	Target proportion %	Difference
Majedie UK Equity	153.2	24	22.5	
Newton Global Equity	224.0	35	32.5	
Baillie Gifford Diversified Growth	110.1	17	15.0	
Schroders Property	36.9	6	8.0	
Schroders Fixed Income Fund	122.9	19	22.0	
TOTAL	**647.1**	**100**	**100.0**	



** Please note these are indicative values, based on 30 September 2019 figures, with the disinvestment/reinvestment amounts applied – this does not reflect the actual value of the investments after the rebalancing.

Also, please note that the rebalanced proportion percentages are rounded, hence may not add to 100 per cent.

<u>TRANSITION MANAGER APPOINTMENT</u>

11. Given the value of the proposed transactions, and the importance of minimising any risk of investment losses as a result of this rebalancing, it was agreed that an adviser should be appointed to provide transition management services to the fund and to manage the discussions with the fund managers.

12. Fund officers reviewed the National Local Government Pension Scheme (LGPS) Framework for Transition Management Services, in conjunction with colleagues from the council's Procurement Team, and undertook a desk-top comparison of prices from the seven providers on the framework against a fee quote provided from Hymans Robertson.

13. Following that review, it was determined that the best value for money, both in terms of lowest fee quote and quality of service provided, would be achieved from Hymans Robertson. This decision has been fully documented in accordance with the council's procurement processes.

<u>TRADING PROGRAMME</u>

14. The timetable for the transition was agreed with the Section 151 Officer, and is summarised below:

		ACCESS (Newton) global equity	Majedie UK equity	Baillie Gifford diversified growth
	Settlement times	T+3	T+2	Deals at 10am, settlement T+3
	Money moving	-£55,000,000	£30,000,000	£25,000,000
Monday 21/10/2019	Plan to IWCPF for approval *(approved by s151 officer 24/10/19)*			
Monday 28/10/2019	Documents sent to IWCPF for signing *(signed by Assistant Director - Finance and Technical Finance Manager 28/10/19))*			
Tuesday 29/10/2019		Send disinvestment form to Link for trade date 30/10	Send investment letter to Majedie for trade date 31/10	Send investment form to BG for trade date 30/10
Wednesday 30/10/2019	T	£55m disinvestment made		£25m investment made
Thursday 31/10/2019	T+1		£30m investment made	
Friday 01/11/2019	T+2			
Monday 04/11/2019	T+3	£55m settles in trustee bank account	£30m cash to be transferred and settle with Majedie	£25m cash to be transferred and settle with Baillie Gifford

15. All dates were compiled in accordance with the above timetable.

TRANSITION COSTS

16. A summary of the transition costs, are shown in the table below:

	Money moved £	**Cost £**	**Bps ***
ACCESS (Newton) global equity	- 55,000,000	60,567	11.0
Majedie UK equity	+ 30,000,000	135,006	45.0
Baillie Gifford diversified growth	+ 25,000,000	60,000	24.0
Total transition costs		**255,573**	**23.2**

* Basis point costs as a percentage of assets traded

17. The total transaction costs incurred by the Fund during the process of the transition from ACCESS (Newton) to Majedie and Baillie Gifford were approximately £256,000 or 0.232 per cent of the value of assets traded. The majority of the costs were related to the Majedie UK equity mandate largely due to stamp duty payable on the purchase of UK equities.

18. Due to the differences between settlement and trade times of the respective funds, £30 million of the disinvestment proceeds were ‘out of market’ for one day between 30 and 31 October 2019 awaiting investment in the Majedie UK mandate.

19. The total estimated cost of being 'out of market' for this one day, was an overall net benefit to the fund of approximately £285,000. This has been estimated using movements in the Majedie UK Equity benchmark index over that day (FTSE All-share). This net benefit is because the FTSE All Share index declined by 0.95 per cent over this period. It was therefore beneficial to the Fund being 'out of market' on this day, as equity markets fell while the Fund was temporarily holding cash.

20. This benefit from being out of market on 31 October 2019 more than offsets the transaction costs incurred by the fund in moving to the new mandates. The overall effect of the rebalancing activity was therefore a net benefit to the fund of approximately £30,000.

21. For the pooled funds (Baillie Gifford and ACCESS (Newton)), transaction costs are charged by way of dilution levy. For the segregated Majedie fund transaction costs were the direct costs associated with purchasing the relevant stocks (ex. stamp duty, broker commission, exchange costs, etc.).

STRATEGIC CONTEXT

22. The primary objective of the fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, in accordance with the Local Government Pension Scheme regulations and statutory provisions. The committee aims to operate the fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing.

23. Specifically, it supports the following investment beliefs agreed by the committee at its meeting in April 2019:

- Strategic asset allocation is the most important component of decision making and it is here that the optimum risk and return profile should be designed and monitored regularly, ensuring managers and mandates remain appropriate for the fund.

- External advice from parties such as an investment consultant helps planning, risk management and decision making.

- Appropriate diversification reduces the overall level of dependence on any particular market or asset class and helps manage volatility, particularly in respect of equity markets.

FINANCIAL / BUDGET IMPLICATIONS

24. The rebalancing of the fund's portfolio incurred some direct costs, specifically the cost of the advice on the rebalancing and the transition management service from Hymans Robertson.

25. As outlined in paragraphs 11-13 above, the fund sought to obtain best value in procuring the transition management services, in line with the council's procurement processes.

26. All direct costs are borne by the pension fund accounts, and have no impact on the council's budget, nor on the contributions payable by employers within the fund.

27. There were also some indirect costs incurred, in terms of the sale and purchase of investments in the market on the trading dates. For the pooled funds (Baillie Gifford and ACCESS (Newton)), transaction costs are charged by way of dilution levy. For the segregated Majedie fund transaction costs were the direct costs associated with purchasing the relevant stocks (ex. stamp duty, broker commission, exchange costs, etc.).

28. As noted in paragraph 17 above, the transition costs were approximately £256,000. Further, as noted in paragraph 19 above, the fund benefited from the one day 'out of market' for UK Equities to by approximately £285,000. Hence the net impact of the rebalancing exercise was a benefit of approximately £30,000 to the fund.

29. These costs will be reflected in the investment valuations reported at the end of December 2019.

LEGAL IMPLICATIONS

30. The council as administering authority has to operate within the relevant statutory provisions related to the Local Government Pension Scheme. In considering any investment it must do so in accordance with its duties in relation to diversification, on the basis of proper investment advice, and taking account of the level of risk and return.

EQUALITY AND DIVERSITY

31. The council, as a public body, is required to meet its statutory obligations under the Equality Act 2010 to have due regard to eliminate unlawful discrimination, promote equal opportunities between people from different groups and to foster good relations between people who share a protected characteristic and people who do not share it. The protected characteristics are: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation.

32. The rebalancing of the pension fund's investment portfolio has no implications for any of the protected characteristics.

RISK MANAGEMENT

33. The strategic asset allocation is set out in the Investment Strategy Statement. It is determined to ensure that the fund's investment assets are invested in such a way as to maximise the likelihood that there will be sufficient resources in the long term to pay the future benefits as they fall due.

34. It is determined as part of a triennial review linking into the formal valuation of the fund. When last formally reviewed, following the 2016 valuation, the committee assessed the likelihood of achieving the fund's long-term funding target – defined as achieving a fully funded position within the next 20 years; while also considering the level of downside risk associated with different strategies by identifying the low funding levels which might emerge in the event of adverse experience.

35. The actual asset allocation in comparison to the agreed strategic allocation is monitored on a quarterly basis and is reported to each investment-focussed committee meeting. Should there be a significant deviation from the strategic asset allocation, the fund's investment consultants will report their recommendations for action to the committee – in some cases this may be to accept the deviation, and in others it may result in a rebalancing of the investments.

36. Bringing the investment portfolio back into line with the strategic asset allocation ensures that the fund is operating within its accepted risk parameters.

37. In carrying out the rebalancing of the fund's investment portfolio, it is important to try to match the trade settlement dates of the redemption and reinvestment, to minimise the time 'out of market' i.e. the risk of market fluctuations having a detrimental impact on the value of investments purchased.

38. Appointing an advisor to provide transition management services has ensured that dedicated resources are available to plan and implement the transition, reducing the risk of unmatched trade periods.

39. In this instance, the trading date for the sale of global equities and the purchase of diversified growth fund units matched (both on 30 October), but the trade date for the purchase of UK equities was one day later (31 October). This exposed the fund to a risk that the UK equity market could move significantly during the one-day settlement difference. This was deemed to be an acceptable risk to the fund.

RECOMMENDATION

40. The committee is asked to note the action taken to rebalance of the fund's investment portfolio.

BACKGROUND PAPERS

41. Investment Performance at 31 March 2019 – Isle of Wight Pension Fund Committee 17 May 2019, paper C2
https://www.iow.gov.uk/Meetings/committees/IW%20Pension%20Fund/17-5-19/PAPER%20C2.pdf

42. Investment Strategy Statement 2019
https://isleofwightpensionfund.org/media/4414/investment-strategy-statement-2019-v23-final.pdf

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