

Investment strategy review – Scoping Document

Addressee

This note is addressed to the Officers of Isle of Wight Council as Administering Authority for the Isle of Wight Pension Fund (“the Fund”). The purpose of this initial scoping document is to set out the range of investment strategies we propose to model as part of the high level review and to outline the content and structure of our report, highlighting any key issues we propose to consider as part of our analysis.

Background

Hymans Robertson have been commissioned to carry out a review of investment strategy for the Fund alongside the 2019 actuarial valuation process. The aim of this review is to assess the effectiveness of the current investment strategy in meeting the Fund’s long term objectives and to test potential variations in strategy that might improve the likelihood of achieving these objectives.

The review will be carried out in two stages.

1. **Settling high level strategy** - Aim to establish the overall optimal expected return and allocation between Growth, Income and Protection assets supported by asset liability modelling (ALM). Quantify the chances that the Fund will achieve its long term funding objective under different investment and contribution strategies.
2. **Detailed asset allocation** - Consider the detailed asset allocation for the Fund in view of the high level modelling. Decide on specific allocations to asset classes and consider how best to access these asset classes aware of current and future funds available in the ACCESS pool. Other implementation considerations will also be addressed such as manager style and Committee beliefs.

The remainder of this note outlines the proposed content of our review for each step.

Investment strategy review

Stage 1 – Setting High Level Strategy

Assess the current strategic asset allocation by undertaking quantitative asset liability modelling on both the current allocation and a range of alternative investment strategies to test their risk and return profiles.

We propose to model a mix of strategies showing the impact of moving from growth to income assets and growth to protection assets but on a more granular basis than in the valuation ComPASS modelling work. As the Fund approaches 100% funding it is important to consider alternative strategies that will aim to provide enough investment return and income to maintain a ‘steady state’ without taking excessive market risk.

We therefore propose considering some alternative income generating credit assets, as these assets will help to diversify equity risk, generate income and provide more stability to the Fund’s return stream. Our modelling will be carried out at Whole Fund level over a rolling period of 20 years and under different levels of long term fixed contribution rates consistent with contribution strategies agreed as part of the 2019 valuation.

New Entrants

Our ALM model allows us to model the impact of new entrants and future accrual of benefits within the Fund. We can model different “replacement rates” of members coming in to the Fund to replace leavers. Our assumption for the analysis is a 100% replacement ratio.

Net cashflows

As part of the review we will include some analysis of the net cashflow position of the Fund based on the liability profile, new entrant expectations and likely contribution pattern. The focus will be on benefit outgo versus contributions and will not cover specific analysis of investment income.

Strategy variations

The following range of investment strategies and asset classes we propose to model are detailed below.

% of Fund assets	Current	10% Growth to Income	10% Growth to Income (2)	20% Growth to Income	20% Growth to Income (2)	10% Growth to Protection	20% Growth to protection
UK equity	22.5	20	20	15	15	20	15
Global Equity	32.5	30	30	25	25	30	25
Diversified Growth	15	10	10	10	0	10	10
Private Equity	-	-	-	-	10	-	-
Total Growth	70	60	60	50	50	60	50
Property	8	8	10	10	10	8	10
Infrastructure	-	5	5	10	10	-	5
Multi Asset Credit	-	-	-	5	5	-	-
Private Debt	-	5	5	5	5	-	5
Total Income	8	18	20	30	30	8	20
Corporate Bonds	22	22	20	20	20	22	20
Government Bonds	-	-	-	-	-	10	10
Total Protection	22	22	20	20	20	32	30
Total Fund	100	100	100	100	100	100	100

The strategies will each be tested against an agreed set of success and risk metrics. This will allow the Committee to easily compare each of the strategies against the Committee's objectives for the Fund.

Stage 2 – Detailed Asset Allocation

Stage 2 of the investment strategy review will focus on the detailed asset allocation within the Growth, Income and Protection components of the Fund's allocation. We will review the role each mandate plays within the strategy and assess the long term suitability of this within the Fund.

We will also consider a number of implementation specific issues, for example new ACCESS developments or implementing the Committee's views on climate change. These will be assessed on a qualitative basis rather than through an ALM process.

Diversifying growth assets

Review the appropriateness of the current split between UK/Overseas and the mix of manager investment styles. Explore the possibility of diversifying the Growth allocation further but introducing another complimentary equity strategy including consideration of the funds available on the ACCESS platform.

Diversifying Income assets

Building from the initial analysis of likely cashflow requirements of the Fund, consider potential income that could be sourced from existing mandates and potential income from new asset classes such as Private Debt or Infrastructure.

Active/passive

Review the current active / passive split of the Fund's assets. Provide advice on the appropriateness of the split given the underlying mandates and investment management fees paid.

Review allocations within growth asset allocations including equity style mixes, the role of non-market cap strategies and the balance of active and passive management.

Pooling considerations

Review the funds currently on offer within the ACCESS pool and consider how the Fund's existing assets could map across to the pooled fund offering. Take future pooling activity into account when providing any advice as part of the strategy review.

Consider the potential for the Fund to access a wider range of assets, in particular, income-focussed assets which can increase the certainty of the Fund achieving its investment objectives.

Responsible Investment and Environment, Social and Governance ("ESG")

Consider the potential for climate risk as a systemic risk that could impact on asset performance and pension liabilities. Propose investment options available to Committee to best reflect their views. These will include, scope for disinvestment, 'tilting' and engagement.

Climate change additional modelling

Should the Committee wish to assess the impact of climate change further we can extend the core ALM modelling to consider the potential impact of Climate Change on future funding outcomes through scenario testing. The modelling is designed to illustrate the potential scale of the risks posed by Climate Change and help provoke discussion at Committee-level for how these risks can be addressed.

The Climate Change analysis would be based on three scenarios representing how governments and businesses might respond to climate risk in future (aligned with the scenarios in our presentation at the recent PLSA conference). We also allow for the potential impact on longevity according to our Club Vita analysis. For each scenario we consider how future economic variables (inflation, interest rates, investment returns, etc) could differ to our current default assumptions, and show the resulting evolution of the funding level. The output from this analysis would be included in the report along with supporting commentary.

The analysis would be focussed on one of the central ALM scenarios being considered, e.g. the current investment and funding plan.

Investment beliefs

We will aim to highlight key considerations throughout each aspect of the strategy review in order to ensure that all investment decisions are conscious and reflective of committee beliefs.

David Walker, Partner

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For and on behalf of Hymans Robertson LLP