Nottinghamshire County Council

Report to Pensions Sub-Committee

07 November 2013

Agenda Item:6

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

WORKING PARTY RECOMMENDATIONS

Purpose of the Report

1. To seek agreement to the recommendations of the Pensions Working Party to make changes to the Fund's bond portfolio.

Information and Advice

2. A meeting of the Pensions Working Party was held on 1 October 2013 to consider proposals for amending the Fund's bond portfolio. The Fund's main bond portfolio at 30 June 2013 was valued at over £409 million. The Fund also has £58 million invested in an Inflation Linked Fund.

3. The Fund's Statement of Investment Principles (SIP) includes agreed asset allocation ranges as follows:

Equities	55% to 75%
Property	5% to 25%
Bonds	10% to 25%
Cash	0% to 10%

4. The SIP states that the 'policy of the Fund will be to treat the equity allocation as a block aimed at maximising the financial returns to the fund' while the bonds are part of a 'block… aimed at lowering overall risk (at the cost of anticipated lower return)'. The use of asset allocation ranges gives the Fund flexibility to decide on various management arrangements in order to balance risk management against the desire to outperform the strategic benchmark.

5. The strategic benchmark is shown below together with the actual asset allocation of the Fund as at 30 June 2013. The liability based benchmark is also shown.

Strategic Benchmark			**Actual 30/6/13**
Equities (inc private equity)	65.0%	FTSE All World	72%
Property	15.0%	IPD annual universe	12%
Bonds	17.5%	FTSE UK Gilt All Stock	13%
Cash	2.5%	LIBID 7 Day	3%
	100.0%		
Liability Based Benchmark	100.0%	FTSE UK Gilts IL > 5 Yrs	

6. The actual allocations show that the Fund continues to be overweight "growth assets" in preference to bonds. The overall investment strategy and the type of investment management used are determined by the Nottinghamshire Pension Fund Committee, advised by this Sub-Committee. Each manager is then given a benchmark against which their performance is measured, the aim being to encourage better performance than the relevant element of the strategic benchmark shown at paragraph 5.

7. The benchmark for the bond portfolio is shown below along with index returns for 1, 3 and 5 years. The manager is given flexibility to under- or over-weight each asset type.

Type	**Benchmark**	**Index Returns**		
	%	**1 year**	**3 yrs pa**	**5 yrs pa**
Gilts	40.0%	-3.0%	4.2%	6.2%
Corporate Bonds	30.0%	3.0%	6.1%	8.5%
European/US Government	20.0%	4.9%	2.2%	6.6%
Index-linked	10.0%	6.6%	8.3%	7.6%

8. The current benchmark is heavily weighted to traditional gilts and includes currency risk in the form of overseas bonds. There is general consensus that gilt yields are likely to rise over the medium term resulting in capital value falls. Rising yields will benefit the Fund as a whole as this is one of the key factors in the discount rate used by the actuaries in calculating the Fund's liabilities (a higher discount rate equals lower liabilities). Sensitivity analysis carried out by the actuaries for the 2012/13 accounts showed that a change in the discount rate of just 0.1% changes the liabilities by around £125 million.

9. However, although the Fund will benefit overall from rising gilt yields, the bond portfolio (as currently structured) will not. The aim of the Working Party, therefore, was to discuss the options available for bond investment within the framework of the SIP and the Fund's strategic benchmark. These discussions resulted in the following recommendations:
    a. Change the portfolio benchmark to:
        i. reduce the weighting to gilts
        ii. increase the weighting to corporate bonds
        iii. remove overseas government bonds entirely
    b. Give flexibility to the manager to invest up to 10% in 'high-yield' bonds
    c. Transfer the index-linked bonds to the Inflation Linked Fund

Statutory and Policy Implications

10. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are

described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That the Nottinghamshire Pension Fund Committee be recommended to approve the following:
   a. Change the portfolio benchmark to:
      i. reduce the weighting to gilts
      ii. increase the weighting to corporate bonds
      iii. remove overseas government bonds entirely
   b. Give flexibility to the manager to invest up to 10% in ‘high-yield’ bonds
   c. Transfer the index-linked bonds to the Inflation Linked Fund

Report Author:
Simon Cunnington
Senior Accountant – Pensions & Treasury Management

For any enquiries about this report please contact: Simon Cunnington

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.