

Pension Fund Committee

Meeting to be held on 22 March 2013

Electoral Division affected: All

Credit and Fixed Income Strategy

(Appendix 'A' refers)

Contact for further information:

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Executive Summary

This paper sets out the Investment Panel's proposed approach to the management of the Pension Fund's allocation to Credit and Fixed Income investments in order to achieve the objectives of the Fund.

Recommendation

The Committee is asked to consider and approve the Strategy.

Background and Advice

On 10 December 2010, the Pension Fund Committee approved the revised Investment and Liability Strategy for the Fund which includes an allocation of 20-40% of the fund to "Lower Volatility Strategies" which provide stability for the Fund and include Fixed Income, PFI, Credit strategies, Infrastructure, Currency and Cash.

The Fund has two objectives in terms of its investment activities:

1. To ensure that resources are available to meet the Fund's liabilities through achieving investment performance at least in line with actuarial assumptions.
2. To achieve full funding (i.e. no funding deficit) over a period no longer than the current recovery period.

The current funding target assumptions include an assumed investment return (discount rate) of a yield based on market returns on UK Government gilt stocks plus 2½%.

In the context of the Fund's objectives and assumptions, the Investment Panel has considered the appropriate deployment of the allocation to Lower Volatility Strategies, particularly to Credit and Fixed Income. The Panel recommends that, subject to appropriate ongoing governance and risk management, the Pension Fund should seek higher returns than the historic investment portfolio (comprising mainly Sterling Investment Grade Bonds and Gilts) can be expected to deliver.

The Panel considers that the current economic situation and particularly the change in the regulatory environment to which banks are subject is presenting opportunities to achieve better yields in the Credit and Fixed Income sphere without necessarily taking on significantly more risk.

The Panel therefore supports a strategy that seeks to diversify away from Investment Grade credit into other areas, including but not limited to: *secured* lending to certain higher risk counterparties; long-term lending, preferably secured, where the Fund can earn an attractive term and liquidity premium; non-sterling lending to governments and other high-grade counterparties; investment opportunities driven by changes to banking regulation; and loans delivering a degree of inflation protection through indexation.

The proposed strategy is set out in Appendix A.

Consultations

Investment Panel

Implications:

The switch from two large Investment Grade managed funds to a larger number of less commoditised and more specialist funds will require one-off due diligence effort to ensure the security and appropriateness of any proposed investment. Much of this work will be carried out by LCPF investment management staff; any external advisory fees relating to this are anticipated to be *de minimis* in the context of the size and expected term of investments being made (equivalent to less than 0.01% per annum).

The annual levels of investment management and administration fees for smaller, specialist funds will typically be higher than those for more commoditised, larger funds. Any investment decision will always be made on the basis of expected return *net* of fees and only if the Investment Panel is of the opinion that the additional returns that are being targeted will more than compensate for any costs necessary to achieve access to more specialist fund management skills.

Risk management

This change will result in a wider range of risk exposures within the portfolio, with risks mitigated through investment due diligence, use of recognised, specialist investment funds and diversification of exposures. However, the different return profile of these investments is expected to provide a more appropriate level of reward for the investment risk taken by the Fund than the current portfolio.

Local Government (Access to Information) Act 1985

List of Background Papers

N/A

Reason for inclusion in Part II, if appropriate

N/A

