TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 7

TEESSIDE PENSION FUND COMMITTEE REPORT

7 MARCH 2018

STRATEGIC DIRECTOR FINANCE, GOVERNANCE & SUPPORT – JAMES BROMILEY

ASSET / LIABILITY STUDY

1. PURPOSE OF THE REPORT

1.1 To present to Members the outcome of the Asset/Liability Study (see Appendix 1), as undertaken by AON Hewitt in conjunction with the Head of Investments and Treasury Management.

2. RECOMMENDATION

2.1 That Members accept the report and new customised benchmark, in principal, with a strategy for moving from the existing customised benchmark to the proposed, new customised benchmark to follow at a later Committee meeting.

2.2 Training may need to be provided in the future to Fund Officers and Pension Fund Committee Members in the new asset classes being proposed (property debt, insurance linked securities and absolute return bonds), together with some other alternative asset classes which have similar characteristics as these asset classes, before a decision is made on the final make-up of the customised benchmark.

3. FINANCIAL IMPLICATIONS

3.1 Changes to the customised benchmark as part of a change to the strategic asset allocation will have an impact on the funding level and performance of the Fund.

4. BACKGROUND

4.1 The Fund's Actuary carries out an Actuarial Valuation every three years. This Valuation determines the contribution rates for the Fund as a whole and for each employer in the Fund. These contribution rates are calculated by the Actuary in order to meet the Fund's current and future liabilities.

4.2 The Actuarial Valuation includes assumptions on the likely return on investments but does not include any detail of investment assets held by the Fund. It also makes no recommendations about the type and mix of investment assets which would best meet the current and future requirements of the Fund – the customised benchmark.

4.3 The Asset/Liability Study is the next step from the Actuarial Valuation, and, together with the proposed customised benchmark, looks at the Fund's requirements over the long-term. The Fund's Investment Advisors will continue to assess market and economic conditions and make short-term asset allocation recommendations to the Investment Panel to take advantage of these current conditions.

5. ASSET/LIABILITY STUDY

5.1 AON Hewitt have carried out the Fund's Asset/Liability Study (ALS) – see Appendix 1. The purpose of the ALS is to assess the Fund and determine the most appropriate strategic asset allocation. In performing this, AON Hewitt also made an assessment on the Fund's probability of funding success and the indicative discount rate, both important factors going forward to subsequent Actuarial Valuations, with a potential impact on the Fund's funding level and employer contribution rates.

5.2 In making this assessment, AON Hewitt have analysed the existing customised benchmark, and assessed a de-risked benchmark, and two other alternative benchmarks which reduce equities and increase illiquid alternative and protection assets. The key summarised outcome of this assessment is below:

	Current Benchmark	Current Actual Allocation	25% from Equities to Bonds	10% from Equities to Alts/Bonds	20% from Equities to Alts/Bonds
Equities	70%	80%	45%	60%	50%
Illiquid Alt's	15%	9%	15%	22½%	30%
Protection	15%	11%	40%	17½%	20%
Discount Rate	4.7%	4.5%	4.1%	4.7%	4.8%
Funding Success	70%	78%	78%	81%	84%

5.3 From the analysis, the move to reduce equities by 20% and overall growth assets (equities and illiquid alternatives) by 5%, and increase protection assets by 5% best suits the Fund, but is a move that is contrary to recent Investment Advisor advice. However, as explained in the presentation (Appendix 1), the purpose of this move is to reduce volatility, particularly from equity markets. The Fund is in a healthy position being fully funded, and protecting this position together with protecting employer contribution rates at low levels are key elements of the Fund's Funding Strategy Statement.

5.4 In addition, it is recognised that the customised benchmark, as the strategic asset allocation, is set to meet the requirements of the Fund over the long term and short term issues in different asset classes and markets will continue to make reaching this benchmark a long term aspiration. Also, given the size of the move away from equities and the increase in illiquid alternative investments, it will take time to achieve the investment allocations of the sizes shown in the far right column.

5.5 It is proposed that a strategy is developed for reducing equities by 20% (approx. £800 million reduction) and increasing allocation to illiquid alternatives (approx. £600 million) and protection assets (approx. £200 million). It is envisaged that this move will be over a period of time, which will span over the cut of date of 31 March 2019 for the next Actuarial Valuation, and will require assistance from Border to Coast Pension Partnership (BCPP) to achieve. It also shows the importance of residual resources in investment management at the Fund over the medium term to either work with BCPP on investment solutions or find bespoke solutions for the Fund.

5.6 Finally, recognising the current situation with Independent Investment Advisors at the Fund, no major changes in asset allocation or the customised benchmark will begin until they are in place and had their opportunity to assess the ALS, and provide their guidance to Members.

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