NORTH YORKSHIRE COUNTY COUNCIL

PENSION FUND COMMITTEE

23 MAY 2019

INVESTMENT STRATEGY REVIEW

Report of the Treasurer

1. PURPOSE OF REPORT

1.1. To review and approve the long term investment strategy of the Fund as part of the 2019 Triennial Valuation.

1.2. To finalise the allocation to BCPP's Global Equity Alpha Fund.

1.3. To consider an initial allocation to the BCPP Multi Asset Credit sub-fund.

1.4. To update on the Equity Protection implementation.

1.5. To update on the UK Equity transition.

2. INVESTMENT STRATEGY REVIEW

2.1. Background and current strategy

2.1.1. The Fund is currently in the process of undertaking an investment strategy review as part of the 2019 Triennial Valuation. The funding level is currently estimated at around 108% using the current investment strategy as the basis of the calculation. It is important to note that this does not reflect any 2019 Triennial Valuation assumptions.

2.1.2. The Fund is in a very different place in terms of its funding level in comparison to previous Valuations. For the first time the Fund is over 100% funded, due to the strong performance of investments seen over recent years. To remind Members, the funding level was 90% at the 2016 Triennial Valuation. The strategy should therefore change as a consequence of this and the Fund can afford to reduce risk to reflect this much improved funding position.

2.1.3. The Committee has been responsive to the improving funding level and as a result has already taken steps to reduce risk in advance of the Valuation. The target allocation for equities has already been reduced by 10% with the intention of investing in alternative asset classes. The table below shows the recent changes made to Investment Strategy and the current actual allocations:

Asset Class	Target Allocation (%)		
	Previous Strategy	Current Strategy	Current temporary actual asset allocation following GARS redemption
Global Equities	52	47	50
UK Equities	10	5	5
Total Equities	**62**	**52**	**55**
Gilts	18	13	15
Total Fixed Income	**18**	**13**	**15**
Property	10	10	10
Absolute return inc DGF & ILS*	10	15	10
Illiquid credit inc Property Debt & Private Debt	0	10	10
Total Alternatives	**20**	**35**	**30**
TOTAL	**100**	**100**	**100**

*ILS = Insurance-Linked Securities, DGF = Diversified Growth Fund

2.1.4. In recognition of equity risk to the Fund, the implementation of an Equity protection strategy has also been approved in the short term to reduce equity risk whilst a long term strategy is determined and implemented. Investment in some alternative asset classes can take a period of time so it is expected that this equity protection will be in place for a period of 1-2 years.

2.2. Next Steps

2.2.1. In the Committee meeting on 23 May there will be further opportunity for discussions with consultants and the independent adviser to review the Investment Strategy. Following on from the presentation in the April special meeting, where a number of different strategy options were presented to the Committee for consideration, Members are asked to determine a high level strategy to inform the Triennial Valuation assumptions. There are a number of stages involved which will be worked through during the meeting; these are set out below:

- Agree the objectives for changes to the Investment Strategy.

  Namely to reduce investment risk to lessen the risk of adverse *future funding positions whilst continuing to target levels of expected investment return which do not increase the current contribution rate*

- Agree investment beliefs of the Fund.

  Namely that the main driver of returns for the portfolio should be equities, that there is a strong belief in active management and that diversification is a useful tool provided that there is a clear rationale for investing in new asset classes

- Agree the level of changes to be made to the strategy

- Agree the level of risk to be taken within the strategy

2.2.2. In the meeting consultants will propose a number of different changes that could be made to the current Strategy and Members are asked to determine a degree of comfort with each of the potential changes. The proposed options for change that will be reviewed in the meeting are listed below:

- Reduce equity by 10 to 15%
- Introduce illiquid growth for example infrastructure – 5-10% allocation
- Introduce liquid credit for example multi-asset credit – 5-10%
- Replace DGF with other absolute return strategies.

2.2.3. There is no expectation that any agreed changes to the strategy will be made immediately as the equity protection strategy ensures that there is time to implement these changes. This is especially important for investments in more illiquid asset classes, where implementation can take a number of years. It also allows time for any education sessions that may be required for any new asset classes.

2.2.4. Based on decisions made above, Members are asked to determine a long-term investment strategy. The following 3 options are proposed in terms of risk:

- Keep the current portfolio and level of risk
- Current portfolio – with c.10% lower risk
- Current portfolio – with c.20% lower risk

Asset Group	Current Strategy	c.10% lower risk Proposal	c.20% lower risk Proposal
Equity	55	45	40
Property	10	10	10
Illiquid growth		7.5	5
Illiquid credit	10	10	10
Liquid credit		7.5	5
Absolute return	10	10	15
Gilts	15	10	15

2.2.5. Given the current funding level and the objective set out above to reduce investment risk to better protect the future funding position, maintaining the current level of risk within the portfolio is not recommended. The Committee has recognised that the strategy has been successful in moving from a significant funding shortfall to a fully funded scheme and that de-risking is therefore appropriate and required. It is important that a decision is made in the meeting to inform the assumptions for the 2019 Triennial Valuation and this needs to fit with the direction of de-risking. Failure to make any changes will mean that the default position is the current strategy with the higher levels of risk and this will be used as the basis of the assumptions for the Triennial Valuation.

3. GLOBAL EQUITIES

3.1. In the February 2019 PFC meeting it was agreed that a £1bn investment in the Global Equity Alpha Fund was still appropriate based on current market conditions, subject to due diligence. This £1bn investment is around 30% of the total Fund value. Authority was delegated to the Treasurer, in consultation with the Chairman of the PFC, to carry out the necessary due diligence on the BCPP Global Equity Alpha Fund.

3.2. To update Members, the table below details the latest position in global equities as at 31 March 2019:

Fund Manager	Value (£m)	Actual Allocation (%)	Base Fee (bps)
Baillie Gifford- GA	649.1	18.2	26*
Baillie Gifford- LTGG	509.4	14.2	29*
Fidelity	283.3	7.9	20
Dodge and Cox	208.3	5.8	60
Veritas	213.9	6.0	51
Total Global Equities	**1,864.0**	**52.1**	**33**

***** The Baillie Gifford fees are on a tiered structure so will vary dependent on the value of the Fund
N.B. please note that the management fees shown above do not include performance fees

3.3. At the time of writing this report the following key information is still outstanding on the global equity sub-fund, but it is expected to be available by the time of the meeting on 23 May 2019:

- The managers of the sub-fund
- The allocation to each manager
- Track records on the managers

3.4. As the sub-fund is due to launch in Q3 2019, Committees have been asked to confirm their final commitment amount by mid-June. As discussed in the February Committee meeting is it difficult to make any final decisions without the full due diligence being completed. A verbal update will be provided in the meeting on the outcomes of the outstanding items above to hopefully allow Members to take an informed decision. BCPP will also be attending the workshop on Friday 24 May so would be able to provide Members with an update on the Global Equity Alpha Fund as part of this, if required.

4. INVESTMENT IN MULTI ASSET CREDIT

4.1. BCPP are currently working on the design of its fixed income sub-funds. To remind Members, the following sub-funds are planned to be launched for fixed income:

- Index Linked Gilts
- Investment Grade Credit
- Private Debt
- Multi Asset Credit

4.2. Multi Asset Credit (MAC) is an investment across a diversified range of different credit asset classes, for example, investment grade corporate bonds, high yield bonds, loans and emerging market debt. These strategies use a combination of credit market beta as well as active manager skill to target higher returns compared with other liquid fixed income investments as well as increased diversification. This strategy is one put forward by Aon as a desirable additional asset class as part of the lower risk investment strategies proposed by Aon under section 2 above.

4.3. It is expected that the BCPP Multi Asset Credit sub-fund will be externally managed using a core/ satellite approach, with one core manager, investing across multiple asset classes, and a number of satellite managers specialising in different asset classes, expected to make up the sub-fund. Whilst this sub-fund is not expected to be launched until around Q2 of 2020, the core Manager is to be appointed in the summer of 2019 so that they can feed in to the selection and allocation of the satellite managers. BCPP are therefore requesting initial indications of commitment levels from Partner Funds to inform the RFP for the core manager by mid-June. Members are asked to provide an indicative initial minimum level of investment to the sub-fund to inform the RFP submission.

4.4. An informal presentation will be provided by BCPP on their Multi Asset Credit offering, along with Infrastructure, on 24 May 2019.

5. EQUITY PROTECTION

5.1. Following the decision to implement an equity protection strategy on the retained global equities at the meeting on 21 February 2019, authority was delegated at the special meeting on 25 April 2019 to the Treasurer, in consultation with the Chair, to select and appoint an equity protection manager.

5.2. Presentations were held with the shortlisted Equity Protection Managers prior to the Committee meeting on the 25 April 2019. During the committee meeting, Members were asked to consider their preference on the Manager to help inform the selection. Following a further review from consultants on the details of the terms of the arrangements, this Manager has now been selected and terms are now in the process being agreed.

6. UK EQUITY TRANSITION UPDATE

6.1. To remind Members, in the Committee meeting on 22 November 2018, the transition of the 5% UK Equities allocation to the BCPP UK Equity Alpha Fund was approved. The Fund already had LGIM appointed as a transition manager so they have been used to manage this process. A verbal update will be provided at the May 2019 meeting.

7. RECOMMENDATIONS

Members are to:

7.1. Agree the long term investment strategy of the Fund (section 2) to inform the 2019 Triennial Valuation assumptions, specifically:

- 7.1.1. Agree the objectives for changes to the Investment Strategy
- 7.1.2. Agree investment beliefs of the Fund.
- 7.1.3. Agree the level of changes to be made to the strategy
- 7.1.4. Agree the level of risk to be taken within the strategy

7.2. Agree the final commitment to the BCPP Global Equity Alpha Fund (section 3).

7.3. Agree an initial indicative allocation to Multi Asset Credit (section 4).

7.4. Note the update on the Equity Protection implementation (section 5).

7.5. Note the update on the UK Equity transition (section 6).

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17 May 2019