Shropshire Council

Committee and Date	Item
Pensions Committee 20 March 2015 10.30am	**8** Public

LDI & UNCONSTRAINED BONDS

Responsible Officer James Walton
e-mail: james.walton@shrophire.gov.uk Tel: (01743) 255011 Fax (01743) 252184

1. Summary

1.1 The Committee, together with the Officers and Aon Hewitt has been reviewing the Fund's investment strategy. This included building a greater understanding of the Fund's investment risk relative to its liabilities. A number of potential improvements to the investment strategy have been discussed with the Committee during training sessions prior to Committee meetings and at the annual training day in July. Following, and subject to, a further training session undertaken directly prior to Pension Committee, the report outlines two recommendations for implementation.

2. Recommendations

2.1 Committee approve the recommendation in Appendix A to begin the process to put in place a Liability Driven Investment (LDI) manager which will replace the current index linked gilt holding. Committee therefore authorise officers to undertake a manager selection process to identify an appropriate LDI Manager.

2.2 Committee approve the recommendation in Appendix A to replace all or part of the investment grade corporate bond allocation with a more unconstrained bond mandate, for example multi asset credit or PIMCO's diversified income Fund. Committee therefore authorise officers to undertake a manager selection process to identify an appropriate Unconstrained Bond Manager.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1 Risk management is considered by Committee in making decisions under the governance arrangements.

3.2 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.3 There are no direct environmental, equalities or climate change consequences of this proposal.

4. Financial Implications

4.1 The potential costs are detailed in Appendix A to this report but will depend on the managers which are appointed during the selection process. It is anticipated that the costs of the selection process as identified within the recommendations will not exceed £50,000.

5. Background

5.1 The Committee, together with Officers and Aon Hewitt has been reviewing the Fund's investment strategy. This included building a greater understanding of the Fund's investment risk relative to its liabilities.

5.2 A number of potential improvements to the investment strategy have been discussed during training sessions prior to Committee meetings and at the annual training day in July.

6. Liability Driven Investment (LDI)

6.1 The present value of the Fund's liabilities, as measured by the Fund's Actuary (Mercer), will increase if long-term gilt yields (interest rates) fall and if long term inflation rises. If this is not matched by a corresponding rise in the Fund's asset value then the funding level will fall.

6.2 The current investment strategy has a 10% allocation to index-linked gilts which will move in a similar way to the liabilities as interest rates and inflation changes. LDI, which uses derivatives, would enable the Fund to more efficiently match its assets to the interest rates and inflation movements of its liabilities.

6.3 Members received training on LDI at the annual training day in July and a further training session will be provided to Committee by Aon Hewitt prior to the start of the meeting and continued training will be provided during implementation.

6.4 Members are asked to approve the recommendation in Appendix A to begin the process to put in place a Liability Driven Investment (LDI) manager which will replace the current index linked gilt holding following a selection process.

7. Investment Grade Bond Allocation

7.1 PIMCO currently manage 7.5% of the Fund in their investment grade corporate bond fund. The Fund has benefited from strong returns from this asset class since 2009. However, the future outlook now appears limited by low yields, low credit spreads and declining liquidity.

7.2 By moving to an unconstrained bond mandate, for example multi-asset credit, the aim is to improve the Fund's risk adjusted returns going forward.

7.3 A further training session will be provided to Members on this prior the start of the meeting outlining the reasons why we should replace all or part of the investment grade corporate bond allocation with a more unconstrained bond mandate.

7.4 Members are asked to approve the recommendation in Appendix A to replace all or part of the investment grade corporate bond allocation with a more unconstrained bond manager, for example multi asset credit or PIMCO's diversified income fund and decide on the allocation.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information N/A
Cabinet Member N/A
Local Member N/A
Appendices A – Aon Hewitt Investment Recommendations