REPORT FOR:	**Pension Fund Investment Panel**
Date of Meeting:	25th June 2012
Subject:	**Review of the Pension Fund's Investment Strategy**
Responsible Officer:	Julie Alderson, Corporate Director of Resources
Exempt:	No.
Enclosures:	Aon Hewitt Report

Section 1 – Summary and Recommendations

The meeting will be preceded by training on diversified growth funds. Following the training, the Panel will be invited to agree a revised investment strategy. The attached note summarises the relevant considerations.

Recommendation:

The Panel is invited to review the options outlined in the Aon Hewitt report and agree a revised investment strategy.

Section 2 – Report

1. Following the completion of the 2010 actuarial valuation and the appointment of Aon Hewitt as investment advisor, the Panel commenced a review of its investment strategy i.e. the appropriate holdings of each of the main asset classes. A number of themes arose from the discussions, the last being at the Panel meeting on 15th November 2011 that are discussed below. Aon Hewitt will present their recommendations to the meeting and seek agreement to a revised strategy.

Balance of risk and return

2. The funding level continues to be main driver of the strategy. At the last valuation the accrued liabilities were 73.5% funded based on a projected investment return of gilts plus 1.6%. Thus an actual return greater than the discount rate is required to close the funding gap.

3. An interim funding position has been calculated by the actuary as at May 2012, which indicated that the funding position has deteriorated. On an ongoing basis the scheme is 62% funded and on a gilts basis it is 48% funded. The deterioration is mainly due to the fall in gilt yields to all time lows, which can perhaps be seen as temporary due to a combination of the flight to 'safety' caused by the Eurozone crisis and the impact of quantitative easing involving the Bank of England buying up a large percentage of the issued gilts.

4. The twin aims of returning to a fully funded status and maintaining the current level of employer contributions requires that the new strategy focus mainly on return generation and maintains a high allocation to growth assets.

5. Aon Hewitt's initial strategy suggestions focused on maximising the probability of achieving a gilts plus 1.6% p.a. thereby allowing a trade off between expected return and volatility of returns. The Panel indicated that they wished to maintain at least the current level of returns.

Introduction of an absolute return allocation

6. Training was provided at the prior meeting on three types of absolute return mandates that offered the opportunity to achieve an improved balance of return and volatility:

    - Fund of hedge funds
    - Individual hedge funds – long/short and global macro
    - Diversified growth funds

7. The Panel concluded that they were uncomfortable with the complexity, the use of derivatives and the fees involved with hedge funds. They agreed to further training on diversified growth funds, which will be given immediately preceding this meeting.

8. Should the Panel decide against an allocation to absolute return, Aon Hewitt is likely to recommend only minor changes to the strategy e.g. to remove the active currency allocation.

Active v Passive

9. One option to increase the expected return was to switch the passive UK equity portfolio to active management. Aon Hewitt advised that this was not a priority and the Panel agreed to defer consideration to a later date.

Private Equity and Infrastructure

10. The current strategy has a 3% allocation to private equity and an actual allocation of 4.8%. Commitments were made to three funds managed by Pantheon in the period 2006-7. These commitments are approximately 75% drawn and the allocation will eventually fall to zero as the underlying investments are sold. Should the Panel wish to maintain a private equity allocation, further commitments will be required and modelling can be undertaken to determine the level of commitments required to maintain the target allocation.

11. The Government is looking at ways to entice pension funds to invest in infrastructure projects such as roads, rail and power generation and has gathered a group of public and private sector funds together to investigate possible structures and projects. The NAPF is seeking to sponsor a fund which aims to generate RPI + 2-5% returns at a 'low risk'. In theory investing in infrastructure offers attractive inflation linked returns if fees can be controlled and construction risks avoided. It is not intended to introduce an infrastructure allocation at this time, although should attractive opportunities arise, these will be brought to the attention of the Panel.

12. The issue of the increasing maturity of the LGPS schemes has been highlighted as a reason for limiting illiquid investments as they restrict the ability to rebalance the fund. The Harrow fund is broadly in balance between contributions and benefits and with the inclusion of investment income remains cash positive and is not likely to face liquidity issues during at least the next 3-5 years.

Passive Currency Hedge

13. The fund maintains a 50% hedge on non sterling denominated equities. Aon Hewitt has previously indicated that for a long term investor an unhedged portfolio will marginally enhance returns through removing transaction costs and the resulting increase in volatility is not significant. Aon Hewitt will be asked to reconfirm their recommendation.

Implementation of the Revised Strategy

14. Should the agreed strategy involve a reduction in the active equity allocations, a proposal on how to allocate this to the three active equity managers will be brought to the September meeting.

Ongoing Monitoring of Strategy and Tactical Opportunities

15. When the strategy is finalised, it will be appropriate to review the process for monitoring the continued appropriateness of the strategy including taking into consideration changes in funding level and expected returns / volatilities of asset classes. Also whether there are opportunities to benefit from tactical / medium term opportunities. It is suggested these issues are considered at a subsequent meeting.

Financial Implications

16. The Strategic asset allocation of the fund is the most significant driver of future returns and risk and the level of contributions required.

Risk Management Implications

17. Risk included on Directorate risk register? No

18. Separate risk register in place? No

19. Setting risk tolerances and measuring outcomes is central to the strategy.

Equalities implications

20. Was an Equality Impact Assessment carried out? Yes

21. There are no direct equalities implications relating to the pension fund.

Corporate Priorities

22. Corporate Priorities are not applicable to Pension Fund as it does not have a direct impact on Council's resources.

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 12 June 2012	√	Chief Financial Officer
Name: Matthew Adams Date: 15 June 2012	√	Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: Papers and training material provided to the PFIP meetings on 12 October and 15 November 2011.

If appropriate, does the report include the following considerations?

1.	Consultation	N/A
2.	Corporate Priorities	N/A

Current and Proposed Asset Allocations

The table below summarised the current and alternative asset allocation previously discussed by the Panel.

Investment Strategy	Current Strategy	Current Allocation	Aon Hewitt Proposal A	Aon Hewitt Proposal B
Bonds	**13**	**17.7**	**15**	**15**
Index Linked	2.6	2.6	5	5
Corporate	10.4	10.5	10	10
Cash	0	4.6	0	0
Equities	**71**	**69.1**	**65**	**60**
UK	26	25.3	25	20
Global	45	43.8	40	40
Alternative	**16**	**13.2**	**20**	**25**
Property	10	8.4	10	10
Private equity	3	4.8	5	5
Currency	3	0	0	0
Absolute return	0	0	5	10
Total	100	100	100	100