Striking the right balance

Natalie Tuck speaks to the Pension Protection Fund's head of investment strategy and liquid portfolio management, Ian Scott, on how the fund uses a bespoke LDI strategy, alongside a growth portfolio, to ensure it has the facility to pay its members

You've been at the Pension Protection Fund for two years now. Can you tell us the responsibilities that come with the role?

A large part of my job is based around working on the PPF's overall investment strategy, both the medium-term approaches that we develop, as well as the long-term plans for the fund. A key part of that is working with the PPF's investment portfolio managers.

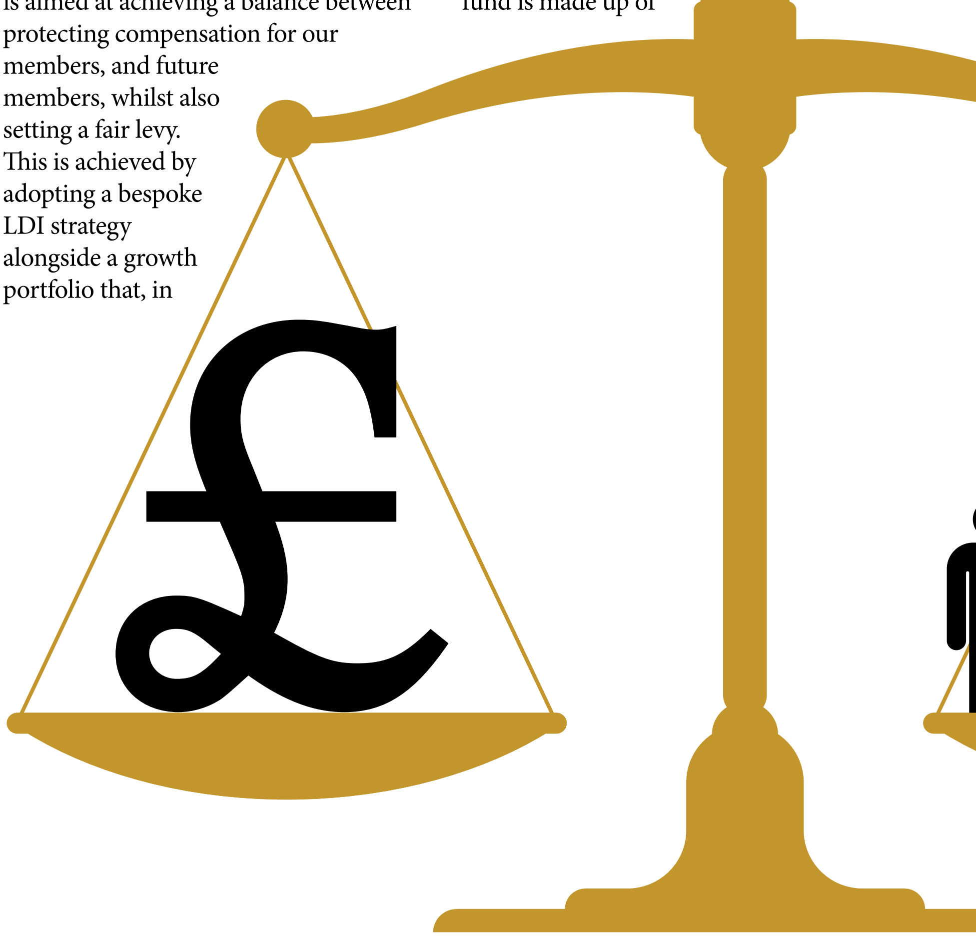
We're lucky that, at the PPF, we work with some of the best investment managers in the business, who are passionate and extremely competent at what they do. Selecting, monitoring and engaging with our external managers is also an extremely important part of this job, while the information and idea flow can help inform our own investment decisions.

For our own part, we've been very proactive in building analytical tools that help us to manage the large quantities of money that we deal with on a day-in, day-out basis. Since joining we've also in-sourced a number of functions, including our cash management, while the intention is to insource more of our investment activity, albeit in a very targeted way.

Talk us through the Pension Protection Fund's investment strategy. What does the PPF's portfolio look like?

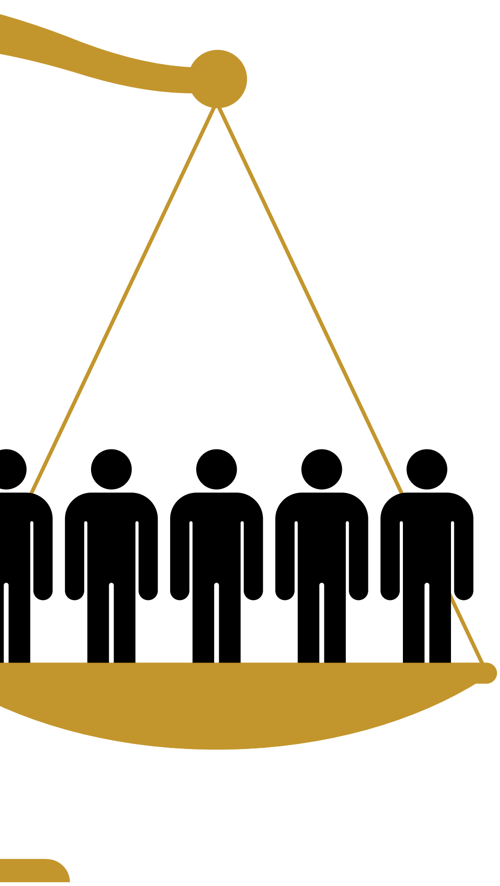
The most important part of our investment strategy is ensuring that we remain on course to achieve our funding objective, which is ultimately to ensure that the PPF has sufficient funds to pay members of eligible DB scheme members that have been transferred to the PPF.

The investment strategy we have set is aimed at achieving a balance between protecting compensation for our members, and future members, whilst also setting a fair levy. This is achieved by adopting a bespoke LDI strategy alongside a growth portfolio that, in combination, targets an expected out-performance over the liability benchmark of 1.8 per cent per annum. Currently, the PPF's strategic asset allocation of the fund is made up of



40 per cent liability-hedging assets (e.g. UK gilts, annuity contracts and inflation swaps), 41.5 per cent return seeking assets (such as property, private equity, farmland equities and corporate credit), 12.5 per cent hybrid assets (illiquid assets with hedging characteristics) and 6 per cent cash.

Our asset allocation is obviously different from the allocations of the average UK DB pension scheme. This is due to the need for a low-risk strategy that aims to be relatively uncorrelated to the funding levels of the schemes it protects, as the fund needs to be solvent at times when general pension schemes are significantly underfunded. Our Statement of Investment Principles (SIP) is a good resource for anyone that wants to look at our investment strategy in further detail. The organisation is extremely proud of the consistency that we've shown over the years with regards to our strategic approach, as well as the performance of the fund more generally.



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How do you manage the risk to the PPF's investments in light of the political instability and market volatility over the past year?
It is worth emphasising that our portfolio is designed to be a low-risk portfolio and is deliberately designed to cope with extreme events in the investment market. The role that we perform, in both the investment industry as well as the wider pensions landscape, certainly demands that of us. It's only right that we plan and analyse the choices that we make in this way, as we have to put our members at the centre of every decision that we make. By its very nature, the influence of politics is difficult to integrate into any investment strategy. However, it's something that every fund should try and do – to ensure that its stakeholders are shielded from those risks as much as possible.

There is a big focus on ESG investments currently, and the PPF has said it believes ESG factors can have a big impact on the long-term performance of its investments. How do you incorporate ESG into the PPF's investment strategy? Does the PPF engage in active stewardship of its investments?
We believe that environmental, social and governance factors can have an impact on the long-term performance of investments, and that the management of ESG risks and exploitation of ESG opportunities, particularly on something wide ranging (like climate change), can add real value to a portfolio. In order to fulfil our commitments, and to protect the value of our investments over the long-term, we know that we have to act as a responsible and vigilant asset owner, as well as a market participant.

The PPF board is also a signatory to the UN Principles of Responsible Investment and uses these principles as a benchmark with which to guide its own approach. In May we also appointed a new head of ESG, in recognition that this is an area that is becoming increasingly important to us as an organisation. So it's certainly something that we've recognised as playing a growing role in the fund's investment strategy.

The PPF has insourced its LDI trading and cash fund, and has plans to bring other aspects in house. What material benefit has insourcing elements of the PPF's investment management had on the fund? How far do you intend to go with insourcing? Can you see a point in the future where it will be purely in house?
There are a number of immediate benefits from insourcing elements of the investment fund's management. However, the main one is control. The PPF is unique in the way that it must function for its stakeholders, and so insourcing parts of our investment activity gives us a greater degree of control over the decisions that we make. In other words, it means that we're able to offer a more bespoke solution for our stakeholders. We have already insourced the bulk of our LDI activity, as well as cash management, and are currently working towards insourcing aspects of our credit portfolio. Looking ahead we plan to insource our foreign exchange activity too.

That said, we do not envisage a situation where we bring everything in-house. We're aware that there will always be expertise outside of the fund that we need to call upon, and will endeavour to strike a balance best suited to our requirements.

Written by Natalie Tuck