East Sussex Pension Fund

Rebalancing Policy

November 2022

Introduction

This is the policy outlining the parameters and process for Rebalancing of the East Sussex Pension Fund (the Fund) investment portfolio in line with the Funds Investment Strategy Statement (ISS).

Regulatory Basis

The ISS is made in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ("the Regulations") and prepared by the Pension Committee ("the Committee") having taken advice from the Fund's investment adviser.

The Committee seeks to invest in accordance with the ISS, any Fund money that is not needed immediately to make payments from the Fund. This Re-Balancing policy will be used to ensure excess Fund money is invested inline with the ISS and that the investment portfolio continues to follow the Committee's strategic asset allocation.

Rebalancing

The Committee has set a strategic benchmark for the Fund that identifies three main classes of investment strategy, which the Committee considers has the appropriate risk and reward characteristics for the employers in the Fund. These high level strategic benchmarks are Growth, Income and Protection. These are then underpinned by a strategic asset allocation, for the asset classes the Fund invests in to gain diversification and manage the risk appropriately. The asset class targets are subsequently met by the appointments of individual managers who are set a portfolio to provide exposure to the asset classes in the strategic benchmark. The managers are expected to provide the market return (beta) for the asset classes in their mandates plus (for the actively managed mandates) additional returns from their active management (alpha) of the investments.

Over time the differential of relative performance between the asset classes and managers results in actual asset allocations (both at a strategic and portfolio level) which deviates from the agreed targets. Deviations from the targets result in tracking error, and a shift in the risk/return profile of the Fund which can have an impact on the Funding level as calculated by the Fund Actuary. Therefore, rebalancing is required to ensure that the appropriate risk is being taken by the Fund.

Rebalancing of asset weightings, entails portfolio transactions, so the benefit has to be weighed against the costs incurred, both in trading and indirectly in the market. Costs of rebalancing are broadly linear (selling twice as much of an asset will cost roughly twice as much). The net benefit of rebalancing is therefore the impact of tracking error less the costs of rebalancing. The exception to this is certain pooled funds where a dilution levy may be triggered if a seller is liquidating a significant holding in the Fund.

The trigger point for a rebalance should be when the benefits of the switch outweigh the costs involved.

The trigger determines when to rebalance, but not by how much. To rebalance all the way to the target allocation is not considered to be cost effective, as the costs of rebalancing all the way tend to outweigh the benefits. The Fund's policy is therefore to rebalance to midpoint from the target allocation and the trigger point in graduated steps were possible.

In normal market conditions

The key risk being run within a pension fund is the proportion invested between the growth, protection and income generating assets. Then to a lesser extent the mix of asset classes that makes up these strategic positions. The Fund's rebalancing procedures will work on the basis that if a trigger point is passed on the strategic positions, this will result in a rebalancing event to take place, following the rules set out below.

If a trigger point is reached by an asset class this will then trigger a rebalance, which may or may not be within the same strategic level looking to bring the most underweight position back in line. The rebalancing will take into consideration if this needs to be done on multiple asset classes to offer the best cost effective rebalancing is actioned.

This policy does not go into the lower level of detail in terms of which investment manager money will be moved from or provide triggers for these as this may cause too much unwanted movements that are not beneficial to the Fund.

In periods of heightened market volatility

The rebalancing policy will be temporarily suspended or slowed if market conditions enter a period of heightened market volatility or other uncertainty as this could force the Fund to sell positions that it does not want to at a price that is not of benefit to the Funds members. That is to say that the cost benefit calculation that this policy is set on may not be valid in these situations and no rebalancing will take place until more certainty on the cost benefit can be derived.

In the situation where the market moves into an advantageous position which enables the Fund to invest outside the Investment Strategy Statement or this rebalancing policy. This would be where the Fund is able to lower the risk in the portfolio whilst maintaining the appropriate the return profile, the Chief Finance Officer will have the ability to invest 5% of the Fund outside the ISS and rebalancing policy.

Liquidity

Rebalancing decisions will be made with due consideration of the liquidity of the underlying assets. In the case of illiquid assets the total commitment will be considered as part of the rebalancing calculation as these can take several years to manifest into actual investments. The uncalled commitments will often be held in a low volatility liquid asset classes in the interim and these funding arrangements will not be subject to rebalancing. Details of liquidity arrangements of the Funds investments is held in a separate operational document.

Rebalancing Ranges

The following ranges have been agreed by the Committee to set as points at which rebalancing should take place.

Strategic Area	Strategic target (%)	Range (%)
Growth	**62.5**	**51.5 – 73.5**
Income	**27.0**	**18.0 – 36.0**
Protection	**10.5**	**8.5 – 14.5**
Total	**100.0**	

Asset class	Liquid/Illiquid	Strategic target (%)	Range (%)
Listed Equities	Liquid	40.0	35.0 – 45.0
Private Equity	Illiquid	5.5	2.5 – 8.5
Absolute Return	Liquid	17	14.0 – 20.0
Total Growth		**62.5**	**52.5 – 72.5**

Asset class	Liquid/Illiquid	Strategic target (%)	Range (%)
Balanced Property	Illiquid	7.0	5.0 – 9.0
Inflation linked Property	illiquid	4.0	2.0 – 6.0
Infrastructure	Illiquid	11.0	8.0 – 14.0
Private Credit	Illiquid	5.0	3.0 – 7.0
Total Income		**27.0**	**18.0 – 36.0**

Asset class	Liquid/Illiquid	Strategic target (%)	Range (%)
Diversified Credit	Liquid	10.5	7.0 - 12.0
Cash	Liquid	0.0	0.0 – 2.0
Total Protection		**10.5**	**7.0 – 14.0**

Principles of Rebalancing

The following principles will determine how the rebalancing process for the Fund will operate.

- **Rebalancing would be monitored on a quarterly basis via the investment monitoring report -** Authority to rebalance will be delegated to, and implemented by, Head of Pensions in liaison with the Investment Implementation Working Group. The Officers and advisers will consider transaction costs and current market conditions ahead of implementation.

- **Quarterly rebalancing will apply only to liquid assets -** Due to the transaction costs and illiquidity associated with the other investments such as property, infrastructure, private debt and private equity rebalancing for those asset classes will be considered on an annual/ad hoc basis;

- **Each benchmark allocation would have a weighted tolerance range –** A tolerance range will be defined for growth and matching assets and each underlying mandate; these tolerance ranges will be used in determining when rebalancing will be considered**;**

- **Cash holdings to be used for rebalancing -** Where possible any net investments or disinvestments should be used to manage allocations, for example, by investing any surplus cash into the most underweight asset class.

- **Rebalancing will occur at two levels; at the growth, income and protection level, and at the mandate level –** The rebalancing process will determine if rebalancing is required between growth, income and protection assets, and separately if rebalancing is required between asset classes. However, it is more important to be willing to incur transaction costs if necessary to rebalance between bonds and equities, for example, than switching between managers with similar mandates (e.g. active and passive global equities).

- **Rebalancing transactions will aim to rebalance allocations out with their tolerance ranges to the midpoint (at least) of the tolerance range –** The mid-point of the tolerance range is the mid-point between a benchmark allocation and its upper or lower tolerance limit. Assuming an asset class with a 40% allocation and a 35%-45% tolerance range, the upper mid-point would be the halfway point between 40-45% (i.e. 42.5%). The lower mid-point would be the halfway point between 35% and 40% (i.e. 37.5%). Historical analysis suggests that this is the best way of balancing the impact of transaction costs against returns.

- **Illiquid asset rebalancing -** The allocations to illiquid assets such as private equity and infrastructure will vary with general market movements and are not easily altered, due to the illiquid nature of the asset classes. Therefore we will also consider commitments made and cashflows to drive any rebalancing being carried out in relation to the Fund's illiquid investments. Due to the nature of illiquid assets with timeliness of access to the market and long commitment call down periods, the illiquid assets will often be adrift of the strategic asset allocation while money is awaiting to be called by the investment managers, so these allocations will often be held in a low volatility liquid asset classes in the interim.

- **The long-term strategic target allocation implementation –** where a long-term strategic target allocation has been agreed but not yet fully implemented we will not look to rebalance any current asset class allocation that is in breach of the defined tolerance ranges if the breach is in the desired direction of travel of the Fund's long-term target allocation. This will avoid unnecessary transaction costs.

- **5% allowance to the Chief Finance Officer –** With advice provided by the Investment Implementation Working Group the Chief Finance Officer has the delegation to invest 5% of the Fund outside of the ISS, implementation plan and rebalancing policy. Any investment made through this delegation will be reported to the Committee at the next available opportunity. This will also trigger a review of the investment strategy of the Fund.

- Beyond this rebalancing policy and in line with the Council Constitution the Chief Finance officer has the delegated authority to take action or decide any other Pension Fund related matter on behalf of the Administering Authority in special or emergency situations, in consultation with the Chair of the Pension Committee, including but not limited to where delay in the purchase or sale of investments might be detrimental to the interests of the East Sussex Pension Fund.