

Extreme makeover

Judge's comment: "SPK's impressive new strategy is not only better diversified but also offers a better expected return than its predecessor"

SPK was established in 1944 by 18 savings banks, but the number of banks using the industry-wide multi-employer scheme has since increased to 137. With a healthy 130% funding level at the end of 2014 and an asset base touching €2.6bn, the scheme's personnel numbers 14 in a streamlined operation that outsources the majority of investment management but retains risk management in-house.

Autumn 2014 saw the completion of the most dramatic investment strategy overhaul ever in SPK's history. Gone is the old 70/30 bond/equity split that favoured long-dated domestic bonds, with the entire passively managed bond portfolio replaced by a mix of flexible bond mandates, property, infrastructure, hedge funds and an innovative alternative risk premia mandate. From a top-down perspective the new portfolio is strategically allocated as follows:

- Equities: 30%
- Bonds: 50%
- Real assets 8%
- Alternatives 12%.

The drivers behind the overhaul were a regulatory reform at the end of 2013 that effectively halved the volatility of SPK's pension liabilities, and the need to adapt to a more challenging return environment. Moreover, SPK realised that it was untenable to sit on a large allocation of long-dated bonds when rates are bound to move either sideways or upwards, as the sharp rise in market rates in the second quarter of 2015 demonstrates.

The long-term return target was set at 5.5%. As this is a minimum target, SPK also needed to define the risk it could take. The most important calculation revealed that, in a really bad year, a negative return of up to 10% would be acceptable. Another change saw the decision-making concerning strategic asset allocation pass from the board to the chief executive officer.

The end result is a well-diversified portfolio

with several return sources. The expected return is 5.7%, which does not take into account the greater alpha potential the new strategy provides. Increasing diversification was crucial, since the old strategy was dominated by equity and duration risk. SPK was very concerned about duration risk and exposure to only two risk premia with an unclear correlation. Of all the changes it undertook, the restructuring of the fixed income portfolio and the introduction of alternatives to the roster are the highlights.

Although the 70% allocated to domestic bonds served the fund well, long-dated domestic bonds lost their status as the core asset class under the 2013 regulatory reforms and SPK concluded that Swedish bonds should compete on the same level as other potential assets. This led to the radical change of reducing the overall bond exposure at the same time as diversifying the allocation to enhance the sources of return. A good example is the introduction of a global multi-asset flexible fixed income mandate with the possibility to go short in duration.

From a risk perspective, introducing the alternatives portfolio was important as it meant SPK could avoid adding traditional equity beta exposure, which accounted for some 90% of its risk budget. SPK chose alternative risk premia strategies, which it describes as a smarter way of capturing systematic risk premia, sometimes implicitly embedded as style biases in long-only portfolios. Although alternative risk premia have traditionally been harvested by hedge funds, SPK believed it was possible to replicate the performance of the average multi-strategy hedge fund by constructing a systematic alternative risk premia portfolio, in essence a low-cost hedge fund smart beta portfolio. The final decision was to allocate 8% to a bespoke alternative risk portfolio and 4% to a market-beta-neutral multi-strategy hedge fund.

SPK

AT A GLANCE

- High funding level of 130%
- Complete investment overhaul with 70% bond portfolio dropped in favour of mixed asset classes
- Introduction of innovative 12% alternatives portfolio

SHORTLISTED

Alecta
SEB Life & Pension
Volvo Car Corporation Pension Fund

JUDGED BY

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SPK

SPK

As at 31 December 2014

Founded: 1944

Type: Defined benefit industry-wide pension fund

Financial data

Assets: €2.63bn

Performance: 8.0% (one year);
5.6% (three years); 6.7% (five years); 6.0% (10 years)

Members

Active: 12,151

Retirees: 14,217

Deferred: 12,770