

REPORT OF THE GROUP DIRECTOR, CORPORATE FINANCE AND RESOURCES		
Investment Strategy Statement and Review Pensions Committee 29th March 2017	Classification PUBLIC	Enclosures One
	Ward(s) affected ALL	AGENDA ITEM NO.

1. INTRODUCTION

- 1.1 This report introduces an updated draft of the new Investment Strategy Statement (ISS), to be introduced from 1st April 2017 in line with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. The updated Investment Strategy set out within the ISS reflects the outcomes of a strategy review exercise carried out following the 2016 actuarial valuation.

2. RECOMMENDATIONS

2.1 The Committee is recommended to:

- Consider a reduction from 60.5% to 50.5% in the Fund's target exposure to equities
- Consider a target 10% allocation to multi asset credit. It is recommended that any approved change be implemented in collaboration with the London CIV, with officers and advisers working together with the CIV to identify suitable strategies before returning to the Pensions Committee with a recommendation.
- If approved, consider the delegation of initial research into suitable multi asset credit approaches to the Group Director, Finance and Corporate Resources.
- Approve the draft Investment Strategy Statement for publication

3. RELATED DECISIONS

- 3.1 Pensions Committee 24th January 2017 – Investment Strategy Statement
3.2 Pensions Committee 6th December 2016 – Investment Strategy Development
3.3 Pensions Committee 18th November 2015 – Investment Strategy

4. COMMENTS OF THE GROUP DIRECTOR, CORPORATE FINANCE AND RESOURCES

- 4.1 This paper sets out a draft Investment Strategy Statement (ISS), following

consultation and discussions at previous Committee meetings. The draft Strategy Statement has been set out to reflect the funding position of the Fund and the investment beliefs of the Committee

- 4.2 Adherence to the principles set out in the Strategy will enable the Fund to take an ordered and prudent approach to the management of its assets, helping to manage the long term costs associated with the Pension Fund. The full consideration and approval of the ISS helps to ensure that the Pensions Committee are fulfilling their responsibilities as quasi Trustees of the Fund and that the Fund's investment objectives and policies are clearly set out in line with the Local Government Pensions Scheme (Management and Investment of Funds) Regulations 2016.
- 4.3 Possible costs that could be incurred through approval of the recommendations detailed above include potential additional investment management costs; however, any such costs would need to be considered against the potential for risk mitigation and the performance of the portfolio as a whole. In implementing the changes highlighted in the ISS, the Fund will look to make use of lower-fee options wherever feasible.

5. COMMENTS OF THE DIRECTOR, LEGAL

- 5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1st November 2016. These Regulations represent an update to the LGPS (Management and Investment of Funds) Regulations 2009 and make a number of changes, including dispensing with the current, explicit limits on specified types of investment and instead charging administering authorities with determining the appropriate mix of investments for their funds.
- 5.2 Regulation 7 of the 2016 Regulations requires the Administering Authority to formulate an Investment Strategy Statement (ISS) in line with guidance published by the Secretary of State. The first such statement must be published by 1st April 2017. Broad powers allow the Government to intervene if an Administering Authority does not publish and maintain an ISS as set out in the guidance.
- 5.3 The Committee has legal responsibilities for the prudent and effective stewardship of the Pension Fund and a clear fiduciary duty in the performance of its functions. Reviewing the Fund's Investment Strategy following the 2016 actuarial valuation helps to ensure that the Strategy remains appropriate given the funding position and assists the Committee in fulfilling this duty.
- 5.5 There are no immediate legal implications arising from this report.

6. REVIEW OF INVESTMENT STRATEGY

- 6.1 New regulations affecting LGPS funds in England and Wales came into force on 1st November 2016. The new Regulations dispense with the current, explicit limits on specified types of investment and, instead, charge administering authorities with determining the appropriate mix of investments for their funds. The quid pro quo for more freedom in the formulation of investment strategies is an obligation upon administering authorities to adhere to official guidance and broad powers allowing the

Government to intervene if they do not.

- 6.2 Regulation 7 of the new Regulations sets out for Administering Authorities what must be included within the new ISS. Items to be included are as follows:
- a requirement to invest fund money in a wide variety of investments;
 - the authority's assessment of the suitability of particular investments and types of investments;
 - the authority's approach to risk, including the ways in which risks are to be assessed and managed;
 - the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
 - the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
 - the authority's policy on the exercise of the rights (including voting rights) attaching to investments
- 6.3 A draft ISS is attached at Appendix 1 to this report. The approach set out within this draft follows a review of the Fund's investment strategy based on the results of the 2016 actuarial valuation. The Fund has used Asset Liability Modelling (ALM) carried out by Hymans Robertson, the Fund's investment consultant, to help set a suitable strategic asset allocation benchmark. The benchmark is consistent with the Committee's views on the appropriate balance between generating a satisfactory long term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities.
- 6.4 The updated strategy has been developed through a consultative process between officers, Members and the Fund's investment consultant. An additional strategy meeting of the Pensions Committee was held on 6th December 2017, with a further consultation meeting with Members being held in March 2017 after completion of the review. Members considered the change in the funding level following the 2016 valuation, the economic outlook over the period and the key risks affecting both current and potential future strategies.
- 6.5 The updated strategy proposes a reduction in the Fund's equity exposure from 60.5% to 50.5%, with the proceeds used to fund an allocation to multi-asset credit. The main drivers behind the proposed change are high current valuations for equities and their potential vulnerability to devaluation if bond yields do start to rise. The proposed change would move a proportion of the Fund from assets that are very dependent upon positive growth outcomes to assets with more predictable returns irrespective of economic conditions.
- 6.6 It is recommended that any approved change be implemented in collaboration with the London CIV, with officers and advisers working together with the CIV to identify suitable strategies before returning to the Pensions Committee with a recommendation. Once a suitable strategy is identified, it is recommended that this be introduced gradually over a 12-month period. The key risk associated with a multi-asset credit strategy is credit risk; it is essential that the chosen strategy be carefully selected to ensure that defaults are properly managed.

- 6.7 The strategy also asks Members to consider a move towards a 25%/75% split between UK and Global equities in the equity portfolio. At present, a little under 50% of the Fund's equity assets, including UK holdings within global mandates, are invested specifically in companies listed on the UK stock market. Ideally, the Fund requires a well diversified equity portfolio to capture the expected long term returns from equity markets without too much exposure to individual companies.
- 6.8 The move towards a split of 25% (UK)/75% (Global) is proposed because the UK stock market is quite concentrated in size terms – over a third of the index, for example, is made up of only 10 stocks. There are also pronounced biases toward some sectors (such as mining and materials and energy) and away from others (such as technology and manufacturing). The large companies within the UK stock market (Royal Dutch Shell, HSBC, GlaxoSmithkline etc.) do tend to be large global businesses rather than companies dependent purely on the UK economy. However, they are significant sized holdings for the Fund relative to many of their global peers whose shares happen to be listed on other overseas stock markets.

7. INVESTMENT STRATEGY STATEMENT

- 7.1 In addition to setting out the proposed updates to the Fund's target asset allocation, the draft ISS also covers a number of other issues as required by Regulation 7 of the 2016 regulations (set out at point 6.2). The statement therefore covers risk management, the Fund's approach to pooling, Environmental, Social and Governance (ESG) considerations and the exercise of voting rights.
- 7.2 The section on risk management covers the key investment risks to which the Fund is exposed and sets out the Fund's approach to mitigating these. As required by the Regulations, the section on pooling sets out details of the London CIV as the Fund's chosen pool and the proportion of its assets the Fund expects to invest through pooling. It also sets out a summary of those assets which the Fund intends to hold outside the pool and the schedule for review of this summary.
- 7.3 The Statement also sets out the Fund's approach to the consideration of ESG factors. This section includes particular detail on the Fund's approach to climate risk, which was considered and approved at the 24th January 2017 Pensions Committee meeting. A further section on the exercise of voting rights considers the Fund's approach to voting and its adherence to the Stewardship Code.
- 7.4 The draft ISS has been shared with the Fund's employers and investment managers; an update on any feedback received will be provided at the Committee meeting.

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Appendices

Appendix 1 – Draft Investment Strategy Statement

Appendix 2 – Investment Strategy Review (Exempt)