HERTFORDSHIRE COUNTY COUNCIL

PENSIONS COMMITTEE
FRIDAY 18 NOVEMBER 2016 AT 10:00AM

Agenda Item No:
4

INVESTMENT STRATEGY REVIEW

Report of the Director of Resources

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1. Purpose of the Report

1.1 To inform the Pension Committee of the process and timetable for the review of the Fund's investment Strategy.

2. Summary

2.1 New investment regulations introduced by the Government require each administering authority to produce and publish new investment strategy statements by 1st April 2017.

2.2 The new investment strategy statement (ISS) replaces, and largely replicates the current Statement of Investment Principles (SIP). The ISS will be required to cover a number of areas, specifically:

- A requirement to invest money in a wide range 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 measured and managed;
- The authority's approach to pooling investments;
- The authority's policy on environmental, social and governance (ESG)considerations and how they affect investment decision making;
- The authority's policy with regard to the stewardship of assets, including the exercise of voting rights; and
- The maximum percentage authorities deem should be allocated to different asset classes or types of investment.

2.3 The new regulations and guidance provides a prudential framework within which investment strategy can be implemented and managed and is less prescriptive than the current regulations.

2.4 The new regulations also support the Government's intention to progress the pooling of investments and authorities will be required to report progress on transitioning assets towards the pool against implementation plans.

2.5 The regulations also enable the Secretary of State the power of intervention and issue direction if he is satisfied that an administering authority is failing to act in accordance with the guidance.

2.6 Whilst this is largely a refresh of our current investment strategy, the key areas that will require a focussed piece of work will be:

- the authority's policy on ESG and consideration of non-financial factors when selecting, retaining and realising investments and we engage over the longer term;
- does the current risk and return objectives still apply in determining asset allocation and the mix of growth and defensive assets; and
- how we weave the requirements of asset pooling into the revised IS.

2.6 In anticipation of the introduction of these new regulations, which come into effect 1st November 2016, the Fund's investment consultant Nick Sykes, Mercer presented a recap of the Fund's current investment strategy at this committee's meeting on 9th September. The Mercer paper also set out a plan for the review of the ISS and that the actuarial valuation results will inform the review by answering the following questions:

- Is the 65/35 growth/defensive asset allocation split still appropriate?
- Are the allocations within the growth and low risk portfolios appropriate?
- Should new asset classes be considered?

Now that we have the initial valuation results we can develop the work that Nick Sykes started when recapping the IS with the objective of having a new investment strategy in place by the 1st April 2017.

2.7 Officers will work with Mercer to review the strategy and bring a draft investment strategy to the Pension Committee on 24 February 2017, for initial review and discussion; this will be a focussed piece of work for this particular committee agenda. If further amendments are required then a revised draft will come to the Pension Committee on 31 March 2017 for final review and agreement.

3. Recommendations

3.1 That the Pensions Committee notes the content of this report and agrees the plan for the review of the Fund's investment strategy.

4. Investment Strategy

4.1 This section provides a summary of the requirements that an Administering Authority must consider when reviewing and setting its investment strategy under the new regulations. Although the new regulations are less prescriptive there are new powers of intervention that the Secretary of State may use through issuing a direction to an administering authority where there is evidence to suggest that an administering authority is acting unreasonably.

4.2 **Directions by the Secretary of State**

One of the main aims of the new investment regulations will be to transfer investment decisions and their consideration more fully to administering authorities. The new regulations relax the regulatory framework and have less central prescription and limits for asset allocation. However, the new regulations introduce a safeguard to ensure that administering authorities act appropriately when using the less prescriptive approach to set and maintain their local IS. Where there is evidence that an authority has acted unreasonably then the Secretary of State may consider intervention but only where this is justified and where the relevant parties have been consulted.

4.3 **Investment of money in a wide variety of investments**

When setting its IS the regulations recommend that Funds have a properly diversified portfolio of assets to reduce overall portfolio risk. When preparing and maintaining a policy on asset diversification, administering authorities:-

- Must take proper advice;
- Must set out clearly the balance between different types of investments;
- Must identify the risks associated with their overall investment strategy; and
- Must periodically review their policy to mitigate against any such risks.

The Hertfordshire Fund has a diversified portfolio of assets and asset allocation is reviewed regularly and will be reviewed again when setting and agreeing the new IS.

4.4 **Suitability of particular investments and types of investments**

Funds will need to consider the suitability of individual investment classes and this will vary according to each Fund's funding and investment policies. When preparing a policy on the suitability of particular investments and types, the regulations state that administering authorities:-

- Must take proper advice;
- Should ensure that asset allocation policy is compatible with achieving their locally determined solvency target; and
- Must review periodically the suitability of their investment portfolio to ensure that returns, risk and volatility are all appropriately managed and are consistent with their overall IS.

The Hertfordshire Fund ensures funds are suitably invested and reviews and monitors its investment allocation regularly. The valuation results will inform this piece of work and whether we want to de-risk further i.e. move to more defensive asset classes if the funding level has improved since the last valuation.

4.5 **Approach to risk, including the ways in which risks are to be measured and managed.**

Every administering authority will have a different approach to the risk it takes when it sets its IS and this will be dependent on its funding level and its appetite for risk. The requirements set out in the guidance state that administering authorities:-

- Must take proper advice;
- State clearly their appetite for risk;
- Should be aware of the risks that may impact on their overall funding and investment strategies;
- Should take measures to counter those risks;
- Should periodically review the assumptions on which their investment strategy is based; and
- Should form contingency plans to limit the impact of risks that might materialise.

This Fund when it last reviewed its IS agreed its appetite for risk against its investment objectives and set an appropriate risk budget. The Fund’s appetite for risk will be reviewed and refreshed as part of this IS review. At the pension committee meeting on the 9th September, Nick Sykes gave this committee a recap of the current IS and questions to be considered in the review of the Fund’s strategy.

4.6 **Approach to pooling investments, including the use of collective investment vehicles and shared services**

This new regulation requires administering authorities to set out their approach to pooling and the proportion of assets that will be invested through the pool. The requirements of this regulation are summarised below:

- Confirm the pooling arrangements meet the criteria set out in the November 2015 investment reform and criteria guidance;
- Set out the proportion of assets to be invested through pooling;
- Set out the structure and governance arrangements of the pool and the mechanisms by which the authority can hold the pool to account;
- Set out the services that will be shared or jointly procured;
- Provide a summary of assets it intends to hold outside the pool along with the rationale and how it demonstrates value for money;
- Regularly review assets that the authority has previously determined should be held outside of the pool, ensuring this continues to demonstrate value for money; and
- Submit an annual report on the progress of asset transfers to the Scheme Advisory Board.

As a member of the ACCESS pool, the Hertfordshire Fund has shown its commitment to pooling and is working with fellow ACCESS members on ensuring that effective governance arrangements are put in place to hold the pool to account. As part of the establishment of the ACCESS pool a detailed plan has been established to develop the governance of the pool, the procurement of the operator and legal advisor, and the establishment of tax efficient sub-funds for managing the ACCESS Funds' assets. The ACCESS pool work will inform this piece of the Strategy and ACCESS officers who share Mercer as an investment consultant are meeting in December to address this piece of the strategy.

4.7 **How environmental, social, or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.**

This regulation requires administering authorities to consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors. In preparing its policy on ESG, an administering authority:-

- Must take proper advice;
- Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors;
- Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments;
- Should not pursue policies that are contrary to UK foreign policy or UK defence policy; and
- Should explain their approach to social investments.

This guidance is stronger than previous regulations on addressing issues of responsible investment and encourages engagement as a tool for long-term investors. This will be a focussed piece of work that officers, Mercers and members will need to work together to develop an approach for the Hertfordshire Fund.

4.8 **The exercise of rights (including voting rights) attaching to investments.**

This regulation encourages administering authorities to consider the best way to engage with companies to promote their long-term success, either directly, in partnership with other investors or through their investment managers, and explain their policy on stewardship with reference to the Stewardship Code. In preparing its policy on the exercise of rights, administering authorities:

- Must give a reason in their Investment Strategy Statement for not adopting a policy of exercising rights, including voting rights, attaching to investments;

- Should, where appropriate, explain their policy on stewardship with reference to the stewardship code;
- Should strongly encourage their fund managers to vote their company shares in line with their policy;
- May wish to appoint an independent proxy voting agent to exercise this proxy voting and monitor the voting activity of the managers; and
- Should publish a report of voting activity as part of their pension fund annual report.

The Hertfordshire Fund engages the services of Institutional Shareholder Services (ISS) to instruct its managers how to vote at the annual general and extraordinary general meetings of the top 350 UK FTSE listed companies. A report is submitted annually to this Committee setting out breaches of voting policy, the next annual report will come to this committee in February 2017. The Hertfordshire Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), a body which engages on behalf of its members with companies on environmental, social and governance matters. As part of the review of the IS, this piece of work will be about formalising what we have in place at the moment and adapting it for the purposes of the regulations.

5. Next Steps

5.1 The Fund's officers will work with Mercer to review the current investment strategy in light of the new investment regulations and taking into consideration the outcome of the Fund valuation results and bring to this Committee in February 2017 a draft for consideration and comment. Subject to any further amendments a final investment strategy will come back to this committee in March 2017 for final sign off.

5.2 As part of the review and final sign off of the investment strategy, the draft IS will also go to the Pension Board for comment at its meeting in February 2017.

References:
Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.