

# Investment Strategy Statement (March 2017)

## Introduction and background

This is the Investment Strategy Statement (“ISS”) of the Warwickshire Pension Fund (“the Fund”), which is administered by Warwickshire County Council, (“the Administering Authority”). The ISS is made in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (“the Regulations”).

The ISS has been prepared by the Fund’s Investment Sub Committee (“the Committee”) having taken advice from the Fund’s investment adviser, Hymans Robertson LLP. The Committee acts on the delegated authority of the Administering Authority.

The ISS, which was approved by the Committee on 13 March 2017, is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Committee has consulted on the contents of the Fund’s investment strategy with such persons it considers appropriate.

The Committee seeks to invest in accordance with the ISS any Fund money that is not needed immediately to make payments from the Fund. The ISS should be read in conjunction with the Fund’s Funding Strategy Statement (dated 01 XXXXXXXX 2017).

## The suitability of particular investments and types of investments

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death for their dependants, on a defined benefits basis. The funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund’s assets and that an appropriate level of contributions is agreed by the employers to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary and/or inflation increases.

The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund. This 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.

The broad approach that the Fund has taken to setting an appropriate investment strategy is as follows:

- In order to generate attractive long term returns on the portfolio, a substantial proportion of the investments will be in growth assets such as equities.
- To reduce the volatility of those growth assets, and to help protect the capital value of the Fund, the remaining portfolio will be invested in risk diversifying assets that have a low correlation with equity markets.
- The Fund will maintain a sufficient level of liquidity in the investment portfolio such that it can facilitate the normal cash flow requirements of the scheme, such as paying pensions.

It is intended that the Fund’s investment strategy will be reviewed at least every three years following actuarial valuations of the Fund.

The Fund is currently carrying out an asset liability modelling exercise following on from the 2016 actuarial valuation. The Fund's liability data from the valuation has been used in the modelling, and the implications of adopting a range of alternative contribution and investment strategies are being assessed. The implications for the future evolution of the Fund will be considered under a wide range of different scenarios.

The Committee will be assessing the likelihood of achieving their long term funding target – which has been defined as achieving a fully funded position within the next 19 years. They will also be considering the level of downside risk associated with different strategies by identifying the low funding levels which might emerge in the event of adverse experience.

A summary of the expected returns and volatility for each asset class included in the modelling is included in Appendix 1.

This approach helps to ensure that the investment strategy takes due account of the maturity profile of the Fund (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the funding bases used).

In addition, the Committee monitors investment strategy on an ongoing basis, focusing on factors including, but not limited to:

- Suitability given the Fund's level of funding and liability profile
- The level of expected risk
- Outlook for asset returns

The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation. The Committee has set ranges around the strategic asset allocation for the traditional asset classes (equities and bonds) and then rebalances the portfolio if any individual asset class moves outside its range.

### Investment of money in a wide variety of investments

#### Asset classes

The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, cash, and property either directly or through pooled funds.

The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products for the purpose of efficient portfolio management or to hedge specific risks.

The Committee reviews the nature of Fund investments on a regular basis, with particular reference to suitability and diversification. The Committee seeks and considers written advice from a suitably qualified person in undertaking such a review. If, at any time, investment in a security or product not previously known to the Committee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

The Fund's current investment strategy is set out below. The table also includes the control ranges agreed for rebalancing purposes and therefore the maximum percentage of total Fund assets that it will invest in these asset classes. In line with the Regulations, the authority's investment strategy does not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007".

<b>Asset class</b>	<b>Strategic Allocation (%)</b>	<b>Asset Allocation Range (%)</b>
UK equities	23.0	+/-2.5
Overseas equities	26.5	+/-2.5
Fundamental global equity	5.0	+/-2.5
Private equity	4.0	n/a
Property	10.0	n/a
Infrastructure	4.0	n/a
Hedge funds	5.0	n/a
<b>Total Growth</b>	<b>77.5</b>	
UK corporate bonds	10.0	+/-1.5
UK government bonds	2.5	+/-0.5
UK index linked bonds	5.0	+/-0.5
Absolute return bonds	5.0	n/a
<b>Total Bonds</b>	<b>22.5</b>	
<b>Total</b>	<b>100.0</b>	

As at 31 March 2016, the expected long term return from the target asset allocation was approximately 4.8% p.a. excluding any benefit from active management.

#### Restrictions on investment

The Regulations have removed the previous restrictions that applied under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The Committee's approach to setting its investment strategy and assessing the suitability of different types of investment takes account of the various risks involved and a rebalancing policy is applied to maintain the asset split close to the agreed asset allocation target. Therefore it is not felt necessary to set additional restrictions on investments.

#### Managers

The Committee has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate, they are consistent with the overall asset allocation for the Fund. The Fund's investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles. The manager of the passive funds in which the Fund invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices.

The individual investment manager mandates in which the Fund assets are currently invested are as follows:-

Investment Manager	Asset Class	Investment style
Legal and General	Equities / Bonds	Passive
Legal and General	Fundamental Global Equity	Passive
Threadneedle	UK Equities	Active
MFS	Global Equities	Active
Schroder	UK Property	Fund of Funds
Threadneedle	UK Property	Balanced Fund
Blackstone	Hedge Funds	Fund of Funds
JP Morgan	Bonds	Absolute Return
Harbourvest	Private Equity	Ongoing fund commitments
Standard Life	Infrastructure	Direct fund
Partners Group	Infrastructure	Ongoing fund commitments

### The approach to risk, including the ways in which risks are to be measured and managed

The Committee is aware that the Fund has a need to take risk (e.g. investing in growth assets) to help it achieve its funding objectives. It has an active risk management programme in place that aims to help it identify the risks being taken and put in place processes to manage, measure, monitor and (where possible) mitigate the risks being taken. One of the Committee's overarching beliefs is to only take as much investment risk as is necessary.

The principal risks affecting the Fund are set out below. We also discuss the Fund's approach to managing these risks and the contingency plans that are in place:

#### Funding risks

- Financial mismatch – The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.
- Changing demographics – The risk that longevity improves and other demographic factors change, increasing the cost of Fund benefits.
- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Fund's liabilities.

The Committee measures and manages financial mismatch in two ways. As indicated above, the Committee has set a strategic asset allocation benchmark for the Fund. This benchmark was set taking into account asset liability modelling which focused on probability of success and level of downside risk. This analysis is being revisited as part of the 2016 valuation process. The Committee assesses risk relative to the strategic benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. The Committee also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The Committee also seeks to understand the assumptions used in any analysis and modelling so they can be compared to their own views and the level of risks associated with these assumptions to be assessed.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

### Asset risks

- Concentration - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Fund’s assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Environmental, social and governance (“ESG”) – The risk that ESG related factors reduce the Fund’s ability to generate the long-term returns.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

The Committee measure and manage asset risks as follows.

The Fund’s strategic asset allocation benchmark invests in a diversified range of asset classes. The Committee has put in place rebalancing arrangements to ensure the Fund’s actual allocation does not deviate substantially from its target. The Fund invests in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, help reduce the Fund’s asset concentration risk. By investing across a range of assets, including liquid quoted equities and bonds, as well as property, the Committee has recognised the need for access to liquidity in the short term.

The Fund invests in a range of overseas markets which provides a diversified approach to currency markets; the Committee also assess the Fund’s currency risk during their risk analysis. Details of the Fund’s approach to managing ESG risks is set out later in this document.

The Committee has considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by appointing more than one manager and having a large proportion of the Scheme’s assets managed on a passive basis. The Committee assess the Fund’s managers’ performance on a regular basis, and will take steps, including potentially replacing one or more of their managers, if underperformance persists.

### Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee seeks suitable professional advice.
- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.
- Stock-lending – The possibility of default and loss of economic rights to Fund assets.

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Fund, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). The Committee has the power to replace a provider should serious concerns exist.

A separate schedule of risks that the Fund monitors is set out in the Fund's Funding Strategy Statement.

### **The approach to pooling investments, including the use of collective investment vehicles and shared services**

The Fund is a participating scheme in the Border to Coast Pensions Partnership (BCPP). The proposed structure and basis on which the BCPP pool will operate was set out in the July 2016 submission to Government.

#### **Assets to be invested in the Pool**

The Fund's intention is to invest its assets through the BCPP pool as and when suitable investment solutions become available. An indicative timetable for investing through the Pool was set out in the July 2016 submission to Government. The key criteria for assessment of Pool solutions will be as follows:

- 1 That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund
- 2 That there is financial benefit to the Fund in investing in the solution offered by the Pool.

At the time of preparing this statement, the detailed parameters and objectives of the BCPP fund range are still being finalised.

The Fund is intending to retain the following assets outside of the BCPP pool:

- Passive investments with Legal and General are currently held through life policies and these will remain assets of the Fund. However, the Fund benefits from joint procurement arrangements by BCPP for these services. Future monitoring of the manager and any retendering exercises will be managed by BCPP.
- The Fund has investments in a number of closed end funds as part of its private markets programme. These funds invest in underlying private equity and infrastructure investments. Each of the individual funds has a fixed life with all assets being returned to investors within a specified period. There is no liquid secondary market for these types of investment – and there is a risk that sales would only be possible at material discounts to net asset value. Therefore, the Committee believes that it is in the best interests of the Fund to retain these investments. New allocations to these asset classes will be made through BCPP once suitable funds have been established.

Any assets not invested in the BCPP pool will be reviewed at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money. The next such review will take place no later than 2020.

#### **Structure and governance of the BCPP Pool**

The July 2016 submission to Government of the BCPP Pool provided a statement addressing the structure and governance of the Pool, the mechanisms by which the Fund can hold the Pool to account and the services that will be shared or jointly procured. Government approved this approach on 12 December 2016. The Fund has been working with the BCPP to progress arrangements on this basis.

These arrangements include establishing a Financial Conduct Authority regulated company to manage the assets of BCPP Funds. Based on legal advice describing the options on holding shares in this company, BCPP Limited, the Fund will hold all voting and non-voting shares rather than the Council. This is because the purpose of the company is to meet the needs of the BCPP Funds in complying with the regulations on pooling, rather than for a Council specific purpose.

As the Pool develops and the structure and governance of the Pool are established, the Fund will include this information in future iterations of the ISS.



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

It is recognised that ESG factors can influence long term investment performance and the ability to achieve long term sustainable returns. The Committee consider the Fund's approach to responsible investment in two key areas:

- **Sustainable investment / ESG factors** – considering the financial impact of environmental, social and governance (ESG) factors on its investments.
- **Stewardship and governance** – acting as responsible and active investors/owners, through considered voting of shares, and engaging with investee company management as part of the investment process.

The Committee takes ESG matters seriously and regularly reviews its policies in this area and its investment managers' approach to ESG.

The Fund believes in collective engagement and is a member of the Local Authority Pension Fund Forum (LAPFF), through which it collectively exercises a voice across a range of corporate governance issues.

At the present time the Committee does not take into account non-financial factors when selecting, retaining, or realising its investments. The Committee understand the Fund is not able to exclude investments in order to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

To date, the Fund's approach to Social investments has largely been to delegate this to their underlying investment managers as part of their overall ESG duties. The Fund's managers report on this matter as part of the Fund's annual ESG review.

The Fund does not hold any assets which it deems to be social investments.

### The exercise of rights (including voting rights) attaching to investments

#### Voting rights

A specialist advisory firm has been appointed to assist the Fund with its approach to voting. The Committee have approved their own policy with the objective of preserving and enhancing long term shareholder value and actively vote on the Fund's holdings through a voting platform.

The service provided by the advisory firm, and the Fund's voting policies, are reviewed on a regular basis.

#### Stewardship

The Committee is a signatory to the Stewardship Code as published by the Financial Reporting Council. The Committee also expects both the BCPP Pool and any directly appointed fund managers to comply with the Stewardship Code and this is monitored on an annual basis. A copy of the Fund's statement of compliance with the Stewardship code can be found in Appendix 3. At the FRC's most recent review, the fund was rated as a tier 1 signatory.

## Appendices

Appendix 1 – Expected returns

Appendix 2 – Statement of compliance with Stewardship code

Appendix 3 – Voting policies ... to be updated

DRAFT



## Appendix 1 Expected returns and volatilities

The table below shows the absolute expected returns (20 year geometric averages), net of fees, and the absolute volatilities (first year's standard deviations) used in the 2016/17 asset liability study.

Asset Class	Expected return % p.a.	Volatility
UK Equities	5.9	16
Overseas Equities	5.6	19
Private Equity	7.0	29
UK Property	3.7	14
Corporate Bonds	2.7	11
Fixed Interest Gilts	2.0	9
Index Linked Gilts	1.2	7

## Appendix 2 Statement of compliance with Stewardship code

<p>Principle 1 – Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities</p>	<p>The fund has a long-standing commitment to responsible share ownership. Stewardship is an integral part of share ownership and therefore of the investment code, and requires the same commitment from fund managers.</p> <p>The practical application of the fund's policy is achieved through a combination of activities including, but not limited to: directly voting our shares, dialogue and liaison with fund managers on key issues and through our membership of the Local Authority Pension Fund Forum (LAPFF). In addition to this Stewardship Code Statement, the fund maintains a Statement of Investment Principles (SIP) which explains investment beliefs in more detail.</p> <p>The fund has a responsibility to its membership to regularly engage with fund managers on their stewardship and it is expected to form part of their presentation(s) to the fund sub-committee.</p> <p>Warwickshire Pension Fund believe that well managed companies provide long term value creation to the fund and that the funds members will be beneficiaries of these companies as strong investment returns improve the funds overall funding level which acts favourably in terms of employer contribution rates.</p>
<p>Principle 2 - Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed</p>	<p>The fund encourages fund managers to have effective policies addressing potential conflicts of interest. In respect of conflicts of interest within the fund, Investment Sub-Committee members are required to make declarations of interest prior to each quarterly meeting.</p> <p>External managers are assessed on potential conflicts of interests and their written policies at the evaluation and appointment stage. Subsequent monitoring takes place to by the fund investment consultant and independent advisor protect the funds interests.</p>
<p>Principle 3 - Institutional investors should monitor their investee companies</p>	<p>Day-to-day responsibility for managing our equity holdings is delegated to our appointed fund managers. The fund expects them to monitor companies, intervene where necessary, and report back regularly on activity undertaken. In addition, the fund actively votes all its equity holdings directly and liaises with the fund managers as necessary.</p> <p>The fund has regular meetings with managers and will assess their effectiveness in their monitoring in investee companies as part of formal portfolio reviews either amongst fund officers or the investment sub-committee.</p>
<p>Principle 4 - Institutional investors should establish clear guidelines on where and how they will escalate their stewardship activities</p>	<p>Responsibility for day-to-day interaction with companies is delegated to the fund's fund managers, including the escalation of engagement when necessary. We expect fund managers to disclose their policies and procedures for escalation in their own Stewardship Code statement. However the fund could escalate through LAPFF by supporting a shareholder resolution.</p> <p>The fund's investment managers can escalate through engagement with the company management team, collaboration with other institutional shareholders, filing shareholder resolutions or ultimately selling the holding of company shares. Ultimately the fund manager will seek to add value to their clients through improved company share performance following such escalation.</p>
<p>Principle 5 - Institutional investors should be willing to act collectively with other investors where appropriate</p>	<p>The fund seeks to work collaboratively with like-minded institutional shareholders in order to maximise the influence that it can have on individual companies and would engage it was felt that the fund and the wider Local Government Pension Scheme would benefit. This is achieved in a variety of ways including through our membership of the LAPFF and ad-hoc initiatives</p>

	<p>proposed by our fund managers or other advisors.</p> <p>The funds contact for any such issues is:</p> <p>Mathew Dawson  Treasury and Pension Fund Manager  Treasury and Pensions  Resources Directorate  Tel: 01926 412227  Email: <a href="mailto:mathewdawson@warwickshire.gov.uk">mathewdawson@warwickshire.gov.uk</a></p>
<p>Principle 6 - Institutional investors should have a clear policy on voting and disclosure of voting activity</p>	<p>The fund directly exercises all votes attached to its global equity holdings. The voting policy is a custom policy based on global and local market best practice principles.</p> <p>All voting decisions are made by Fund officers using a variety of inputs including, but not limited to, specialist proxy research.</p> <p>The funds proxy voting system logs all fund voting and uses the funds voting policy to indicate a suggested voting intention that best represents the investment sub-committee's approved policy. A detailed report is also available written by the funds proxy research.</p> <p>The policy is reviewed at least annually by officers in order to take account of regulatory developments. In the event of any changes to the policy, a revised policy would be presented to the investment sub-committee for discussion and approval.</p> <p>Fund voting records can be found at:  <a href="http://www.warwickshire.gov.uk/pensionstatement">http://www.warwickshire.gov.uk/pensionstatement</a></p> <p>The fund does take part in stock lending through its global custodian (Bank of New York Mellon). Stock is not routinely recalled in the event of a company meeting.</p> <p>Within segregated mandates, the fund has absolute discretion over whether stock lending is permitted. The Authority permits stock lending in their active mandates. The manager of pooled funds may undertake a certain amount of stock lending on behalf of unitholders in the fund. If a pooled fund engages in this activity, the extent to which it does so is disclosed by the manager. The fund has no direct control over stock lending in pooled funds.</p>
<p>Principle 7 - Institutional investors should report periodically on their stewardship and voting activities.</p>	<p>The fund reports annually on stewardship activity undertaken during the year in the report and accounts and a presentation is given to members who have the opportunity to ask questions about the fund's stewardship activities.</p> <p>In the event of significant engagements through any given year the voting activity would be recorded in the fund's annual report and available with voting records on the fund's website for the benefit of the funds membership.</p> <p>External active managers do not vote on behalf of the fund, however fund officers engage with the governance teams at the fund manager for discussions and would be required to submit their voting if requested.</p>