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18 January 2019

Pensions Panel

A meeting of the panel will be held at **10.00 am** on **Monday, 28 January 2019** at **County Hall, Chichester**.

Tony Kershaw
Director of Law and Assurance

Agenda

Part I

10.00 am 1. **Declarations of Interests**

Members and officers are invited to make any declaration of personal or prejudicial interests that they may have in relation to items on the agenda and are reminded to make any declarations at any stage during the meeting if it becomes apparent that this may be required when a particular item or issue is considered.

It is recorded in the register of interests that:

- Dr. Walsh is a Member of the Littlehampton Harbour Board, Arun District Council and Littlehampton Town Council
- Mr Donnelly is a Horsham District Councillor
- Mr Jupp has a daughter who works for Blackrock

These financial interests only need to be declared at the meeting if there is an agenda item to which they relate.

10.02 am 2. **Part I Minutes of the last meeting** (Pages 5 - 10)

The Panel is asked to agree the Part I minutes of the meeting of the Panel held on 1 November 2018 attached (cream paper).

10.04 am 3. **Urgent Matters**

Items not on the agenda, which the Chairman of the meeting is of the opinion, should be considered as a matter of urgency by reason of special circumstances.

10.04 am	4.	**Part II Matters**
		Members are asked to indicate at this stage if they wish the meeting to consider bringing into Part I any items on the Part II agenda.
10.05 am	5.	**Investment Strategy** (Pages 11 - 32)
		Report by the Director of Finance, Performance and Procurement.
		The Panel will also receive a presentation from Hymans Robertson.
		The Panel is asked to consider the options presented in the report and within the presentation provided during the meeting.
10.35 am	6.	**Pension Fund Policy Documents** (To Follow)
		Report by the Director of Finance, Performance and Procurement.
		The Panel is asked to consider the recommendation within the report.
10.50 am	7.	**Date of the next meeting**
		The next meeting of the Pensions Panel will be 10.00 a.m. 29 April 2019 at County Hall.

Part II

10.52 am	8.	**Exclusion of Press and Public**
		The Board is asked to consider in respect of the following item(s) whether the public, including the press, should be excluded from the meeting on the grounds of exemption under Part I of Schedule 12A of the Local Government Act 1972, as indicated below, and because, in all the circumstances of the case, the public interest in maintaining the exemption of that information outweighs the public interest in disclosing the information.
10.52 am	9.	**Part II Minutes of the last meeting** (Pages 33 - 36)
		To confirm the Part II minutes of the meeting of the Panel held on 1 November 2018, for members of the Panel only (yellow paper).
10.55 am	10.	**Investment Pooling** (Pages 37 - 66)
		Report by Director Finance, Performance and Procurement attached for members of the Panel only (yellow paper).

The Panel is asked to consider the recommendations within the report.

11.15 am | 11. | **Review of Pension Performance**

The following reports are for the Panel to review Pension performance over the last quarter.

(a) **Transaction and Performance** (To Follow)

Paper by the Director of Finance, Performance and Procurement summarising transactions and performance during the quarter, for members of the Panel only (yellow paper).

(b) **Independent Fund Advisor Comments** (To Follow)

Paper from the independent fund advisor giving comments on the quarter, for members of the Panel only (yellow paper).

11.25 am | 12. | **Business Plan (including Pension Administration)** (Pages 67 - 76)

Report by Director Finance, Performance and Procurement attached for members of the Panel only (yellow paper).

The Panel is asked to consider the recommendations within the report.

11.45 am | 13. | **Presentation by Baillie Gifford**

The Panel to receive a presentation on portfolio performance.

12.30 pm | 14. | **Presentation by Aberdeen Standard**

The Panel to receive a presentation on portfolio performance.

To all members of the Pensions Panel

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Pensions Panel

1 November 2018 – At a meeting of the Pensions Panel held at 10.00 am at County Hall, Chichester.

Present: Mr Hunt (Chairman)

Mr Bradford, Mr Elkins, Mr Jupp, Mrs Urquhart, Dr Walsh, Mr Donnelly and Ms Taylor

Apologies were received from Mrs Dennis

Part I

70. Declarations of Interests

70.1 No interests were declared.

71. Part I Minutes of the last meeting

71.1 Steven Law, Hymans Robertson, commented that minute 63.8 should say 'an amber flag' rather than 'a red flag'. The Panel agreed to the amendment.

71.2 Resolved – That the Part I minutes of the Pensions Panel held on 25 July 2018, amended as above, be approved as a correct record, and that they be signed by the Chairman.

72. Minutes of the Annual Meeting of the Pension Fund

72.1 Resolved – That the minutes of the Annual Meeting of the Pension Fund held on 25 July 2018 be approved as a correct record, and that they be signed by the Chairman.

73. Investment Strategy

73.1 The Panel considered a report by the Director of Finance, Performance and Procurement (copy appended to the signed minutes).

73.2 Rachel Wood, Pension Fund Investment Strategist, introduced the report and informed the Panel that the funding level was 106.3%.

73.3 Members of the Pensions Panel had previously had an informal meeting where infrastructure and private debt investment options had been discussed and so David Walker, Hymans Robertson, gave a presentation to the Panel on Income Asset Considerations (copy appended to the signed minutes).

73.4 The presentation outlined the details for the different types of investment including examples and risks.

73.5 The Panel made comments including those that follow.

- Queried the definition of Social infrastructure. – *David Walker explained that this referred to schools and hospitals. The Panel discussed the consideration that was being given to investment in local housing in West Sussex. Katharine Eberhart, Director of Finance, Performance and Procurement, explained that this option could not be used if it provided a less favourable risk adjusted return than in other geographical areas.*
- Noted the social benefits of social investments, but raised concerns on the level of returns. – *The Panel noted that their duty was the financial stability of the fund and that the Panel's focus was different from the County Council's. Steven Law commented that other Local Government Pension Schemes had made social investments which could be looked into to see the results. Caroline Burton, Independent Fund Advisor, commented that Manchester had found it difficult to balance investment and social responsibility in this field.*
- Raised concerns on the risks associated with Private Debt investments and queried if there was a need to deviate from the current fund strategy. – *Jeremy Hunt explained that the need to change the strategy had already been established, but acknowledged the concerns about Private Debt as an option.*
- Queried the risks involved with Private Debt and what yields could be expected. – *David Walker acknowledged the risks and explained that careful manager appointment would be important. Returns could be 5-7% over Libor and preferred strategies with a focus on senior secured debt.*

73.6 Jeremy Hunt noted the concerns of the Panel and acknowledged the need for more testing and investigation on the discussed investment options.

73.7 Resolved - That the Panel supports the work of officers with Fund advisers to develop the options around income based asset allocation, to include the advantages and disadvantages, for further consideration.

74. Actuarial Matters

74.1 Steven Law gave a presentation to the Panel on hot topics for Local Government Pension Schemes (LGPS) (copy appended to the signed minutes).

74.2 Steven Law began by reporting on the Government Actuary's Department (GAD) Section 13 valuation and how this could impact the West Sussex Pension Fund.

74.3 Steven Law discussed Cost Cap Valuations and how the calculations looked into the impact of staff promotion and life expectancy. These factors were considered when looking at the value of the Scheme for members. The expectation was that lower pay employee contributions would change.

74.4 Steven Law explained the plan to bring LGPS funding valuations in line with National Scheme valuations and highlighted the timeline within the presentation to achieve this. Steven Law explained that it would be possible to set a contribution rate for the County Council for five years, but admitted bodies may require more frequent funding assessments.

74.5 The Panel made comments including those that follow.

- Queried the impact of the Cost Cap Valuations for the LGPS. – *Steven Law explained that that employer rates would remain for the LGPS, however the Fire Fighters pension would see employer rates rise from 17% to 30%. Rachel Wood clarified that this would impact the County Council, but not the pension fund.*
- Sought clarity on the impact of the changes for lower pay employee contributions. – *Steven Law resolved to look into this and provide detail for the Panel.*
- Asked how long life considerations were used for the fund. – *Steven Law explained the Club Vita work which looked at mortality risks for the fund. Social economic effects were also considered. Mortality assumptions and West Sussex profiling would impact the scheme now for those retiring in 30 years.*

74.6 The Panel thanked Steven Law for the presentation.

75. Business Plan

75.1 The Panel considered a report by the Director of Finance, Performance and Procurement (copy appended to the signed minutes).

75.2 Steve Harrison, Financial Planning Manager, introduced the report and gave an update on the current progress with pooling where sub fund negotiations were taking place.

75.3 Steve Harrison reported that work was continuing with Capita in preparation for the administration transfer.

75.4 Steve Harrison highlighted the training strategy within the report that would ensure a common strategy for the Pensions Panel and the Pension Advisory Board.

75.5 The Panel made comments including those that follow.

- Queried the use of the term 'Pension Board' within the training strategy. – *Steven Law confirmed that this reference referred to the Pension Advisory Board and that this was the term that the Pensions Regulator term for local pension boards.*
- Asked if members could receive as much notice as possible when they were notified about training events. – *Rachel Wood resolved to see if earlier notice could be given. Members also requested guidance on which training to attend.*
- Highlighted that the training log was missing some attended events and should also include historic training that had been undertaken. – *Rachel Wood resolved to look into this.*
- Requested training on private equity. – *Rachel Wood resolved to look into this.*

- Sought reassurance that the administration migration plan was robust and asked if the Panel could look at it. *– Steve Harrison resolved to share the plan.*

75.6 Resolved – That the progress made on the Fund Business Plan is noted and that the Training Strategy is noted and agreed.

76. Date of the next meeting

76.1 The Panel noted that its next scheduled meeting would take place on 28 January 2019 at County Hall, Chichester.

77. Exclusion of Press and Public

77.1 Resolved - That under Section 100(4) of the Local Government Act 1972, the public be excluded from the meeting for the following item of business on the grounds that it involves the likely disclosure of exempt information as defined in Part I, of Schedule 12A, of the Act by virtue of the paragraph specified under the item and that, in all the circumstances of the case, the public interest in maintaining the exemption of that information outweighs the public interest in disclosing the information.

78. Part II Minutes of the last meeting

The Panel agreed the Part II minutes of the Pensions Panel held on 25 July 2018.

79. Update on Pensions Administration

The Panel received an update from the Director of Finance, Performance and Procurement on the Pension Administration transfer to Hampshire County Council.

The Panel noted the update.

80. Review of Pension Performance

The Panel considered a paper by the Director of Finance, Performance and Procurement.

The Panel received an update from Caroline Burton relating to the quarterly performance reports from the fund managers.

The Panel welcomed the advice.

81. Presentation by UBS

The Panel received an update from Malcolm Gordon, Jonathan Davies and Scott Wilkin from UBS on the portfolio performance for the quarter.

82. Presentation by Partners Group

The Panel received an update from Alexander Ott, Sarah Brewer and Courtney Bensen from Partners Group on the portfolio performance.

The meeting ended at 2.15 pm

Chairman

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Pensions Panel

28 January 2019

Investment Strategy

Report by Director of Finance, Performance and Procurement

Executive Summary

The Pensions Panel have considered the Fund's investment strategy in the context of the de-risking triggers being exhausted and the strong funding position being maintained by the Fund. This resulted in the decision to reduce its allocation to 'growth' assets in favour of an allocation to 'income' assets.

The Panel has considered investment in infrastructure and private debt, which both fulfil the criteria of being income focused assets. As part of their meeting discussion in November 2018 some Members of the Pension Panel raised concerns on the risks associated with private debt investments. However there was a request that further detail was provided for consideration. The report proposes the types of investments within each asset class within the Panel's risk and return expectations and in recognition of the market with infrastructure investment being focused on global, core brownfield investments across a broad range of income sources and any allocation to private debt being focused on global senior secured direct corporate lending. In this context the Panel could expect to achieve long term returns of 7-10% p.a. net of fees for infrastructure investments and 5-7% p.a. net of fees and costs (based on current LIBOR rates) for private debt.

In respect of any interim arrangement, whilst acknowledgement that any investment in infrastructure or private debt may take a period to build to the target allocation, Hymans would recommend retaining the existing equity holdings until the new income assets were ready to draw funds.

Recommendation(s)

1. The Panel considers the options presented in the report and within the presentation provided during the meeting.

2. Officers are asked to work with the Panel's advisers to develop a Specification for the Fund's income asset allocation for consideration at its meeting on 29 April 2019, based on the Panel's feedback during the meeting.

Background

1. The Pension Panel's Business Plan includes a priority relating to the Fund's Investment Strategy in respect of the Fund's strong asset performance, the need to ensure that the investment strategy remains aligned to meet its long term objectives and in the context of Environmental, Social and Governance (ESG) issues.

2. In addition, the Pension Fund's risk register includes the risk that there are insufficient funds to meet pension obligations resulting in the Fund changing to a higher risk investment strategy and that the Pension Fund does not provide a clear and suitable investment strategy for Fund managers to follow.

3. Following the decisions made by the Pensions Panel in respect of the Pension Fund's investment strategy framework it is appropriate for the Pensions Panel to consider asset types in consideration of its 'income' strategic allocation.

4. As reported at its last meeting, the Pensions Panel have considered the Fund's investment strategy in the context of the de-risking triggers being exhausted and the strong funding position being maintained by the Fund. This resulted in the decision to reduce its allocation to 'growth' assets in favour of an allocation to 'income' assets. The strategic allocation is shown in the table below. The additional allocation to 'income' assets was in part achieved by the re-categorisation of the direct property portfolio, reflecting the mandate guideline to generate a reliable income. However the Panel needs to make a decision on the appropriate asset class for its additional target allocation to income focused investments.

Asset Type	Asset Class	Allocation	Geography
Growth	Listed Equity	40.0%	Diversified
Growth	Private Equity	00.0%	Diversified
Income	Direct Property	10.0%	UK
Income	TBD	10.0%	TBD
Protection	Bonds	40.0%	Diversified

5. The Pension Panel has determined a set of Investment Beliefs to inform its decision making. These are shown in Appendix A.

Income Assets

6. At its informal meeting in September 2018 and their formal meeting in November 2018, the Pension Panel considered some potential options for new income focussed asset classes, with a preference towards infrastructure and private debt. The rationale for considering these asset classes were as follows:

- The current market outlook for these assets looks attractive relative to many other asset classes. Whilst the Panel believes that it should not take short term tactical asset allocation positions it is considered that both have a strong income component to the return stream giving some visibility and increased confidence over the expected returns that can be achieved and is therefore a longer term strategic asset allocation.

- Both are relatively illiquid investments but this is aligned to the long term investment horizon available to the Fund, which can benefit from the illiquidity premium. The Pensions Panel believes that illiquid investments should be considered where an attractive premium return is expected to be available, though the total allocation within the Fund will be limited.

- Both offer attractive levels of risk adjusted returns which are aligned to the investment and funding requirements of the Fund. The Panel considers that the level of risk within the investment strategy should be considered in conjunction with the funding position of the Fund. Different levels of risk may be taken at different funding levels.

7. As part of their meeting in November the Panel raised concerns on the risks associated with Private Debt investments.

8. Since the Pension Panel last met, the Ministry for Housing, Communities and Local Government have issued a Consultation on Statutory Guidance on Asset Pooling for Local Government Pension Schemes. Extracts have been included as Appendix B. This is relevant in the context of infrastructure investment, local investments, investments outside the ACCESS asset pool and investment in other asset pools. The latter matters are relevant for infrastructure and private debt considerations where the Guidance proposes:

   - Pool members may invest through pool vehicles in a pool other than their own where collaboration across pools or specialisation by pools can deliver improved net returns.

   - During the period of transition where Pools are put in place the agreed range of pool vehicles, an individual Authority may make new investments outside the pool, if following consultation with the pool company, they consider this is essential to deliver their investment strategy. This exemption only applies until the pool vehicles needed to provide the agreed asset allocation are in place.

Infrastructure

9. As part of their Consultation on Asset Pooling, MHCLG have proposed the following definition of Infrastructure assets as:

Facilities and structures needed for the functioning of communities and to support economic development. When considered as an investment asset class, infrastructure investments are normally expected to have most of the following characteristics:

- *Substantially backed by durable physical assets;*
- *Long life and low risk of obsolescence;*
- *Identifiable and reliable cash flow, preferably either explicitly or implicitly inflation-linked;*
- *Revenues largely isolated from the business cycle and competition, for example, through long term contracts, regulated monopolies or high barriers to entry;*
- *Returns to show limited correlation to other asset classes.*

10. It goes on to propose that key sectors for infrastructure include transportation networks, power generation, energy distribution and storage, water supply and distribution, communications networks, health and education facilities, social accommodation and private sector housing and that whilst conventional commercial property is not normally included (except where it forms part of a broader infrastructure asset) helps urban regeneration or serves societal needs, all residential property should be included in this definition of infrastructure.

11. This definition reinforces that the investment universe within infrastructure is very broad.

12. Hymans recommends that the Fund's Strategy should look to generate target returns in the region of 7-10% p.a. net of fees. This could be achieved by focusing on:

Recommendation	Rationale
Core brownfield infrastructure equity but with some ability to invest in some value-add initiatives and potential development as part of a broader strategy.	The stage of the asset is a key driver to risk and return. A greenfield asset has some level of development or construction requirement and risk. A core brownfield asset on the other hand is a developed asset albeit that it may still require some expenditure and expansion but is viewed as the safest way for infrastructure investors to secure long term yields that generally match liabilities. Whilst there two definitions are not perfect. Some investments could be made towards non-core infrastructure (such as Government services, social infrastructure, rail rolling stock, energy metering, telecommunication towers, student accommodation and data centres) or some greenfield infrastructure development (dependent on expertise) to provide some higher return. IT would also provide diversification.
A broad range of income sources across different sectors and a mix of exposures to contractual income and economic activity.	The income source is a key drivers for risk and return eg, sector, contractual income and exposure to economic activity result in different volatility A broad range of income sources should ensure diversification of risk and blend lower return and income investments with higher return investments
Global infrastructure predominately on OECD countries in order to avoid niche strategies or concentrated exposures to particular markets.	A global mandate provides a broader and more diverse opportunity set and allows greater relative value assessments where there could be potential pricing pressures. Locally focussed infrastructure and housing investments should be considered separately from the core allocation to infrastructure due to the more bespoke nature of these investment, the likelihood of concentration risk and potential conflicts of interest that would need to be addressed as part of any investment opportunity.

13. The ACCESS Joint Committee requested that Officers progress to look at options for pooling infrastructure investments. The full report is appended. (Appendix C – Part II item). This report was considered prior to the MHCLG Consultation on Asset Pools.

14. Without knowing the outcome of the pooling solution, it is recommended that the implementation route in the short to medium term could be via open ended strategies, closed-ended strategies or funds of funds but should exclude listed infrastructure funds and infrastructure debt only strategies.

15. Over the longer term, the Government wishes to see a variety of platforms being available to implement the infrastructure investment strategies including direct and co-investment opportunities.

<u>Private debt</u>

16. Like infrastructure, private debt is a broad asset class offering a wide range of opportunities with different risk and return characteristics.

17. Hymans would recommend that the Fund's Strategy should look for an expected returns in the region of LIBOR plus 4-6% p.a. net of fees and costs and have a priority on security of income. LIBOR is currently c.0.9%. This could be achieved by focusing on:

Recommendation	Rationale
Senior secured direct corporate lending (first or second lien) where it is possible to generate attractive returns. This could potentially include an allocation to real estate lending and infrastructure debt, mezzanine (junior debt) and other forms of debt and potentially a small allocation to equity.	The quality of the loan terms applied and the purpose of the loan (where in a capital structure a loan sits and the covenants in place around this and whether the loan is corporate debt, infrastructure debt, property debt etc) are key drivers to the risk and return. Senior secured direct corporate lending allows the fund to access attractive returns and the income stream this offers. However the recommendation allows some flexibility for managers to have limited access to wider illiquid debt opportunities for relative value purposes and manage risk and return needs and to give access to some deals where a wider exposure is desired by the borrower.
Global in nature but with a focus on markets with strong lender protections and regulatory controls eg. North America and Europe. Approaches should be considered with a bias to either region where consistent with the manager's skill set.	This will allow the Fund to achieve a broad diversified opportunity set but ensuring investor protections are in place for the Fund. Flexibility in the recommended global bias to Europe or North America should be determined largely by credibility of manager choice but return and risk requirements would be maintained regardless of solution.

Managers who show evidence of a robust process for sourcing, underwriting and structuring transactions and in risk management, in particular the avoidance of issuer default, the management of prepayment risk (to mitigate against any potential deterioration in yield expectations), implementation risk and liquidity risk (given the set terms of the Fund and co-investor risk).	It is important the manager has the ability to deploy capital by originating loans without compromising on credit quality, ensuring penalties are in place to manage risks and achieve required returns.
Manager who show strong workout capabilities, including restructuring, in the event of issuer default.	Should a company get into difficulty it's important that the Fund has a manager that can step in, restructure debt if needed and even take control of the company to ensure you are paid as a lender.

18. Whilst being mindful of the work underway by the ACCESS Joint Committee it is unlikely that there will be a formal opportunity to invest in private debt via a pooling arrangement in the next 12 months. Therefore the implementation route could include open ended strategies, closed-ended strategies or funds of funds but would most likely be sourced through closed ended, limited partnership funds, with terms of typically 7 years plus (comprising a one - two year investment period and 5 year repayment period).

Allocation sizes to new asset classes

19. The strategic review agreed an additional target allocation of 10% to income focussed assets.

20. The Panel has previously expressed a preference for avoiding a large number of separate manager relationships and has in the past considered any allocation to an asset class should exceed 5% to be sufficiently meaningful to have the desired impact on the risk and return profile of the Fund. This would allow the Panel to allocate to only one of the asset classes, or to both.

21. Hymans would recommend that the Panel considers an allocation of 5% each to infrastructure and private debt. The two asset classes, while both income focussed, have different risk and return characteristics that would sit well together as part of a broader income allocation.

22. However should the Panel only wish to pursue one asset class then a starting allocation of 5% might be considered with a view to increasing this to 10% if no other asset opportunities were considered. A 10% allocation to infrastructure would be feasible but Hymans would note that it may take time to build depending on the route of implementation. For private debt 10% would be quite a sizeable allocation and may be harder to build given the shorter term nature of the fund terms.

23. In the context of the above, and given that either investment may take some time to fund given their more illiquid nature, the Panel may wish to consider interim investment options.

Interim Investment Options

24. Both infrastructure and private debt investment opportunities are relatively illiquid. The nature of the investment means that funds are generally drawn down and invested over a period of time which could typically be between one and five years. The Panel may therefore wish to consider potential interim investment options where the Panel could allocate capital ahead of it being drawn down to fund the income solutions. These have been set out in Appendix D alongside comments from Hymans in respect of their suitability.

25. Hymans view is that as a long term investor the Fund can withstand short term volatility and has already taken steps to reduce risk. They would therefore support retaining the existing equity holdings until the new income assets were ready to draw funds. However, if the Panel are concerned about the level of risk Hymans preference would either be to move the funds into gilts or cash/cash plus solutions. This could either be done through physical asset sales and purchases or through a derivate overlay.

Katharine Eberhart
Director of Finance, Performance and Procurement

Contact: Rachel Wood, Pension Fund Strategist, 033 022 23387

Appendices
Appendix A - Investment Beliefs
Appendix B - Local Government Pension Scheme Statutory guidance on asset pooling
Appendix C - ACCESS Report - (Part II paper for members of the Panel only)
Appendix D - Interim Investment Options

Background Papers
None

Investment Beliefs

Governance

A well run fund offers a number of benefits, most notably improving funding outcomes.

1. The Fund's investment strategy should be reviewed using asset liability modelling in conjunction with each actuarial valuation.

2. The Panel has a preference for avoiding a large number of separate manager relationships.

3. Fees and costs incurred within investment manager mandates are important though the emphasis is on achieving the best returns for the Fund net of fees.

4. Active management of the Fund’s investments is expected to provide higher returns net of fees to the Fund over the long term than passive (index-tracking) investment.

5. The performance of active managers should be assessed over suitably long periods.

Structural

There exists a relationship between the level of risk taken and the rate of expected investment return.

6. As the Fund remains open to new members and employer covenants are generally strong, it is appropriate to take a long term view when setting the investment strategy.

7. There is expected to be a long term risk premium to be earned from investing in equities, credit, property and illiquid assets, relative to government bonds.

8. Illiquid investments should be considered where an attractive premium return is expected to be available, though the total allocation within the Fund will be limited.

9. Local investments should be considered, though the risks and expected returns should be commensurate with comparable investment opportunities elsewhere.

Strategic

Return and risk should be considered relative to the Fund's liabilities, funding position and contribution strategy.

10. The level of risk within the investment strategy should be considered in conjunction with the funding position of the Fund. Different levels of risk may be taken at different funding levels.

11. The Fund should take investment risk in order to meet its objective of stable and affordable contribution rates for employers.

12. The Panel should not take short term tactical asset allocation positions relative to the strategic asset allocation.

13. The Panel do not expect the Fund's managers to take substantial short term tactical asset allocation positions relative to their benchmarks. Mandates will be defined accordingly.

Responsible Investment

Environmental, social and governance (**ESG**) considerations should all be taken into account when making and holding investments.

14. Well managed companies will produce superior returns for the Fund over the long term.

15. The Fund should exercise its voting rights as fully as possible.

16. The Fund should engage with managers on environmental, social and governance issues relating to its investments.

17. Corporate engagement is preferred to exclusion of stocks from the Fund.

Local Government Pension Scheme Statutory guidance on asset pooling

Extract 1

6.2 A small proportion of a pool member's assets may be invested in local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member. Local assets should:

- Not normally exceed an aggregate 5% of the value of the pool member's assets at the point of investment.
- Be subject to a similar assessment of risk, return and fit with investment strategy as any other investment.

Extract 2

7 Infrastructure investment

7.1 Infrastructure investment has the potential to provide secure long term returns with a good fit to pension liabilities, and form part of investment strategies of authorities. The establishment of the pools was intended to provide the scale needed for cost-effective investment in infrastructure, and to increase capacity and capability to invest in infrastructure.

7.2 There is no target for infrastructure investment for pool members or pools, but pool members are expected to set an ambition on investment in this area. Pool companies may provide pool vehicles for investment in UK assets, or overseas assets, or both, as required to provide the risk and return profile to meet pool member investment strategies. However the Government expects pool companies to provide the capability and capacity for pools over time to move towards levels of infrastructure investment similar to overseas pension funds of comparable aggregate size.

7.3 Pool companies may provide pool vehicles for investment in existing (brownfield) or new (greenfield) infrastructure, based on an assessment of the benefits and risks in relation to pool member liabilities, and non-financial factors where relevant. Pool members may invest in their own geographic areas but the asset selection and allocation decisions should normally be taken by the pool company in order to manage any potential conflicts of interest effectively, maintain propriety, and ensure robust evaluation of the case for investment.

7.4 For the purpose of producing annual reports, infrastructure assets are defined in the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance *Preparing the Annual Report* as follows:

Infrastructure assets are the facilities and structures needed for the functioning of communities and to support economic development. When considered as an investment asset class, infrastructure investments are normally expected to have most of the following characteristics:

- Substantially backed by durable physical assets;
- Long life and low risk of obsolescence;
- Identifiable and reliable cash flow, preferably either explicitly or implicitly inflation-linked;

- Revenues largely isolated from the business cycle and competition, for example, through long term contracts, regulated monopolies or high barriers to entry;
- Returns to show limited correlation to other asset classes.

Key sectors for infrastructure include transportation networks, power generation, energy distribution and storage, water supply and distribution, communications networks, health and education facilities, social accommodation and private sector housing.

Conventional commercial property is not normally included, but where it forms part of a broader infrastructure asset, helps urban regeneration or serves societal needs it may be.

7.5 All residential property is included in this definition of infrastructure. It is not restricted to social accommodation or private sector housing.

7.6 A variety of platforms may be required to implement the infrastructure investment strategies of pool members. Pool companies are expected to provide access to a range of options over time including direct and co-investment opportunities.

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Interim Investment Options

Interim options	Comments	Viability
Retain listed equity	This option retains the current allocation until funds are drawn for the income mandates and therefore the current risk return profile will be unchanged. While the aim of moving to income is to diversify risk, the fund is a long term investor and can withstand short term volatility and has already taken steps to de-risk out of equity into protection assets.	This remains a viable option and would not require any immediate action.
Property or private equity	Both these assets are too illiquid and costly to consider as an interim solution and plans are already being considered to get them back to their strategic targets.	This is not a viable option owing to its illiquidity.
Absolute return	The Fund has an existing allocation to absolute return strategies through UBS focussed on generating returns through relative currency market positions. This is a liquid investment and it would be easier to move money into and out of over a shorter time period. However, Hymans consider this to be a growth asset which can be highly volatile and is not suitable as an interim risk reduction option.	This is not a viable option owing to the risk.

Interim options	Comments	Viability
Move to existing bond allocations	Existing bond allocations consist of a mix of gilts and corporate bonds. The allocation has been increased as part of the de-risking activity over recent years. While reasonably liquid to move money in or out of there are trading costs, particularly on corporate bonds, which need to be considered as an interim solution. A move to bonds has an impact on the levels of expected returns in the current low yield environment, albeit it would be a short term position. Focussing on corporate bonds might provide higher expected returns but would have higher round trip trading costs. Conventional gilts would provide greater downside protection and lower trading cost but lower expected returns. If there is a real concern over equity risk then a move to gilts would be a viable interim solution. Note: Hymans currently favour fixed gilts rather than index-linked gilts given current pricing and relative value.	This is a viable option but would reduce expected levels of return.

Interim options	Comments	Viability
Derivative overlays	An alternative solution to the above would be to put in place a derivative overlay to reduce exposure to equities and replace it with a synthetic exposure to corporate bonds or gilts. Implementing via an overlay would reduce round trip costs and also allows a longer time period to carry out physical sales of equity assets. The impact on risk would depend on the desired exposures put in place. This may require a procurement process likely involving the national transition manager framework.	This is not a viable option for a shorter term solution.
Equity protection	The existing equity allocation could be retained but the risk profile adjusted through some form of structured equity solution. These can be structured in a wide variety of ways including protecting the fund from falls in equities below a certain level at the cost of a premium or selling away some of the upside. This would likely require a procurement exercise and significant training and familiarisation before implementing and would not be our preferred option.	This is not a viable option for a shorter term solution.

Interim options	Comments	Viability
Move to cash/liquidity funds	Sell the equities and invest in cash or cash like investments through some form of liquidity fund which could be via an existing manager mandates or via the custodian. The expected returns on cash in the short to medium term are low but cash provides the benefit of preserving capital. While there will be costs in selling down the equities the costs of moving the money into some form of cash solution and then using this to fund the income opportunities would be low.	This is a viable option but would reduce expected levels of return.
Move to secured income funds	There are an increasing range of secured income funds that invest across a broad range of income focussed asset classes including real assets like infrastructure and debt assets like private lending. While there are often shorter time periods to get money invested than direct allocations to infrastructure and private debt there is typically a lock up period and liquidity is in some cases untested.	This is not a viable option due to the illiquidity.
Move to cash plus funds	Investment in some form of cash plus fund which comprises more liquid alternative credit assets such as high grade asset backed securities or loans. This could offer a higher return than normal cash funds but greater liquidity than secured income strategies. This may involve some new asset classes and a potential procurement search.	

Interim options	Comments	Viability
Listed infrastructure	Specifically for the infrastructure allocation an interim option could be to move assets into listed infrastructure. Whilst this would still be an equity investment it would have a greater exposure to infrastructure companies that may be expected to move more in line with the underlying infrastructure assets they develop and invest in. However, there would be a round trip cost to consider and the Fund would still be exposed to broader equity market volatility.	

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