DRAFT Investment Strategy Statement

Introduction

1. West Sussex County Council is responsible for administering the West Sussex County Council Pension Fund under the Local Government Pension Scheme (LGPS) Regulations. The Council has a duty to ensure that scheme funds not immediately required to pay pension benefits are suitably invested and to take proper advice in the execution of this function. It has delegated responsibilities to the Pensions Panel.

2. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities to formulate and to publish a statement of its investment strategy (the Investment Strategy Statement), in accordance with guidance issued from time to time by the Secretary of State. The Investment Strategy Statement is an important tool for the Fund and provides transparency in relation to how Fund investments are managed.

3. This Statement will be reviewed at least every three years and will be updated to reflect any substantive changes in the interim.

Investment strategy and the process for ensuring suitability of investments

4. When considering its investment strategy it is important to consider:

   - The Regulations require that the Fund maintains as nearly constant employer contribution rates as possible and takes a prudent long term view, and this is reflected in the Funding Strategy Statement.
   - The objective to maintain affordability of the Fund to employers as far as this is reasonable, as set out in the Funding Strategy Statement.
   - The Investment Strategy objective to meet pension liabilities as they fall due, maximising returns while keeping risk within acceptable limits and contribute towards achieving and maintaining full funding.
   - The Pension Panel’s investment beliefs as set out in Annex A.

5. When a Fund is in deficit then the focus is on repair. However the objectives when the Fund is at full funding – or in surplus – become harder to define. On the basis of the above, the following objectives are considered appropriate:

   - Reduce risk of deficits emerging to protect against increases in the secondary (deficit contribution) rate.
   - Generate sufficient returns to keep the cost of new benefits accruing reasonable. The future service rate is difficult to manage through an investment strategy but the investment strategy must support the Actuary’s funding assumptions.

- Identify sources of income in order to generate cash as the Fund requires. The Fund is currently cash flow positive but if cash-flow drops then the Fund does not want to be a forced seller of assets to pay benefits.

6. The Panel have translated their objectives and beliefs into a suitable customised benchmark which is based on advice from the Fund Actuary and Investment Adviser and which sets out the intended long term weighting to various types of investment (or asset classes), such as equities, bonds and property and reflects the Pension Fund's investment strategy.

7. The benchmark is set using Asset Liability Modelling in order to understand the impact of different investment strategies on the chances of "success" and corresponding downside risks. "Success" here is defined as maintaining a 2/3 or better chance of being fully funded (on an on-going basis) over 20 years.

8. The Fund's investment strategy has been considered in broad terms – growth assets, income assets and protection assets:

Asset Type	Purpose
Growth	• Generate returns in line with equities • Provide liquidity for de-risking • Keep contributions affordable
Income	• Generate a reliable income providing additional cash flows if required • Additional yield versus protection assets
Protection	• Change value in line with liabilities • Protect against movements in interest rates and inflation expectations • Provide liquidity for re-risking • Keep contributions stable

9. This strategic allocation is set out in more detail below.

Asset Type	Asset Class	Strategic Allocation	Geography	Currency
Growth	Listed Equity	40.0%	Diversified	Diversified
Growth	Private Equity	0.0%	Diversified	Diversified
Income	Direct property	10.0%	UK	GBP
Income	[TBD]	10.0%	[TBD]	[TBD]
Protection	Bonds	40.0%	Diversified	Diversified

10. In the context of the table above it should be noted:

- Cash: The Fund has a 0% allocation to cash. However cash is held by the Fund's investment managers within ranges (0-10%) to settle trades and take tactical investment decisions, and working balances are managed to pay benefits, cover invoices and fund private equity and direct property acquisitions.

- Private Equity: The Fund's allocation to private equity is being wound down and therefore not within the strategic allocation.
- Income: The Pensions Panel have agreed a further 10% allocation to income assets. However it will take a period to determine the appropriate asset class to invest in and a period of time to implement the investment (over three years, depending on the assets considered). An interim solution may therefore be appropriate.
- Tactical Asset Allocation: The Pension Fund has 85% of its assets with two large balanced managers. This means that the managers can hold a mix of equities, bonds and cash and move between the different asset classes (within ranges) dependent on their view of the market.

11. The Panel had previously agreed a mechanism for reducing the level of investment risk as the funding position improved. The de-riskng strategy has now been fully applied and the move from growth assets to protection assets should reduce year on year volatility and reduce the changes of poorer funding outcomes over the medium / long term. However:

    - If the funding level falls back below 85%, the Pensions Panel will consider increasing the proportion of growth assets (to no more than 80% of the portfolio) and/or raising the contribution rate target. Therefore there is a need for 20% of the Protection assets to be very liquid.
    - If the funding level continues to increase, the Fund may be able to reduce contributions in a controlled manner or build further prudence into the funding assumptions to allow further certainty of contributions in the future. Further modelling work will be required if the funding level continued to rise beyond 120%.

Social, environmental and corporate governance policy

12. The Pensions Panel is mindful of its legal duty to obtain the best possible return on the investments of the Pension Fund it administers, consistent with an appropriate risk profile. However, good practice in terms of social, environmental and corporate governance issues is likely to impact positively on companies' financial performance. At the present time the Panel does not take into account non-financial factors when selecting, retaining, or realising its investments.

13. The Pensions Panel has directed the fund managers, in acting in the best financial interests of the Fund, to consider, amongst other factors, the effects of social, environmental and governance issues on the performance of a company when considering the acquisition, retention or realisation of investments for the Fund. In this regard, the Pensions Panel has adopted the fund managers' standard socially responsible investment policies. These policies are discussed with the fund managers from time to time and fund managers report quarterly to the Pensions Panel on corporate governance activity.

14. The investment managers have adopted the Institutional Shareholder Committee's (ISC's) Statement of Principles on the responsibilities of institutional shareholders and agents which aims to secure value for beneficiaries over the longer term through engagement. Shareholders should set out:

- Their policy on how they will discharge their responsibilities,
- Clarifying the priorities attached to particular issues and when they will take action,
- Monitor the performance of, and establish, where necessary, a regular dialogue with investee companies; and
- Intervene where necessary and evaluate the impact of their engagement and report back to the Fund.

15. In addition the Fund's investment managers have signed up to the United Nations Principles of Responsible Investment (UNPRI) which has been set up by the United Nations Environment Programme Finance Initiative (UNEP FI) to encouraged asset owners and asset managers to incorporate environmental, social and governance (ESG) issues into investment analysis and decision making, be active owners, seek disclosure of ESG issues and promote the principles within the industry.

16. Details of the investment managers' governance principles can be found on their websites.

<u>Policy on the exercise of rights</u>

17. The Pensions Panel wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles, which in turn will feed through into good performance. The Fund is committed to reviewing its position on becoming a signatory of the FRC UK Stewardship Code as Asset Owners.

18. The Fund's investment managers are all signatories to the FRC UK Stewardship Code as Asset Managers and in practice, managers have delegated authority to exercise the Fund's voting rights according to agreed guidelines, set out below:

Issue	Policy
General	Continuing dialogue with companies Vote on all UK issues
Uncontroversial Issues	Vote with management
Executive Remuneration - Basic Pay	Must be viable and based on market rate
Executive Remuneration - Incentive Pay	Must be viable and based on above average returns to shareholders
Non-Executive Directors	Vote against re-appointment if failed to perform their duties
Employment contracts	One year
Political donations	Vote against
Shareholder incentive schemes	Each proposal judged on its merits.

19. Fund managers report to the Panel quarterly on their voting activity and officers monitor the percentage of domestic and foreign shareholders meetings voted at monthly, and this is reported in the Annual Report.

Approach to Asset Pooling

20. The Fund is part of the ACCESS Pool (A Collaboration of Central Eastern and Southern Shires), and is committed to pooling to comply with the Government criteria published in November 2015.

21. The Fund's intention is to invest its assets through the ACCESS Pool as and when suitable pool investment solutions become available, based on the following considerations:

- That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund
- That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

22. The Fund intends to keep its property allocation and private equity investments outside of the formal pooling arrangement proposed on the basis of ongoing value for money, large one-off transition costs and illiquidity of these assets.

Risk Measurement and management

23. The Panel 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.

24. The principal risks affecting the Fund are set out in Annex B, along with the mitigations and the contingency plans that are in place.

25. The Pensions Panel maintains a full risk register to identify key risks, consider and assess the significance, likelihood of occurrence and potential impact of the risk as part of its Business Plan.

Advice taken

26. In compliance with Guidance on Preparing and Maintaining an Investment Strategy Statement, this document has been prepared after taking appropriate advice.

Annex A

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 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.

Annex B

Risks

Risk	Mitigation
Funding Risks	
Financial mismatch *The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.*	The Panel 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. The Panel assesses risk relative to the strategic benchmark by monitoring the Fund's asset allocation relative to the benchmark and considers actual returns versus the actuary's assumptions.
Changing demographics *The risk that longevity improves and other demographic factors change, increasing the cost of Fund benefits.*	The Fund participates in Club Vita modelling which considers the specific demographics associated with members participating in the Fund and takes a prudent view on longevity and other demographics when calculating its liabilities.
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 Panel maintains a diversified portfolio. However it is not possible to make specific provision for all possible eventualities.

Asset Risk	
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.*	The Panel has set a diversified strategic asset allocation benchmark for the Fund and 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.
Illiquidity *The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.*	The Pension Fund is currently cash flow positive and therefore does not need to sell investments to fund benefits. Notwithstanding this, by setting a strategic benchmark which invests across a range of assets, including liquid quoted equities and bonds, as well as property, the Panel can gain liquidity in the short term.
Currency risk *The risk that the currency of the Fund's assets underperforms relative to Sterling (i.e. the currency of the liabilities).*	The Fund invests in a range of overseas markets which provides a diversified approach to currency markets and has taken a view that currency risk (positive or negative) should be neutral over the longer term.
Environmental, social and governance ("ESG") *The risk that ESG related factors reduce the Fund's ability to generate the long-term returns.*	The Pensions Panel is mindful of its legal duty to obtain the best possible return on the investments of the Pension Fund it administers, consistent with an appropriate risk profile. Details of the Fund's approach to managing ESG risks are set out later in this document.
Manager underperformance *The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.*	The Panel 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 Panel seeks suitable professional advice.
Custody risk *The risk of losing economic rights to Fund assets, when held in custody or when being traded.*	The Fund maintains its beneficial ownership of assets when held in custody or trading and it does this through its global custodian. Counterparty risk is mitigated through a robust selection and legal contracting process.

Credit default *The possibility of default of a counterparty in meeting its obligations.*	The Panel 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 Panel has the power to replace a provider should serious concerns exist.
Stock-lending *The possibility of default and loss of economic rights to Fund assets.*	The Pension Fund undertakes a limited programme of stock lending. Risk is mitigated through counterparty management.