Croydon Council

REPORT TO:	**Pension Committee** **17 September 2019**
SUBJECT:	**Review of the Investment Strategy Statement**
LEAD OFFICER:	**Nigel Cook, Head of Pensions and Treasury**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Resources**
WARDS:	**All**
CORPORATE PRIORITY/POLICY CONTEXT: Sound Financial Management: This report relates to the statutory requirement to set an Investment Strategy, a critical aspect of the management of the Pension Fund.	
FINANCIAL SUMMARY: There are no direct financial implications associated with this report but the continued viability of the Scheme depends on adherence to an effective investment strategy.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	

1. RECOMMENDATION

1.1 The Committee is invited to approve the approach set out in this report to drafting a revised Investment Strategy Statement and to delegate to the Director of Finance, Investment and Risk and section 151 officer in consultation with the Chairman of the Committee the final approval of the Investment Strategy Statement.

2. EXECUTIVE SUMMARY

2.1 This report asks the Committee to approve the approach set out in this report to deliver a draft revised Investment Strategy Statement ("ISS").

3 DETAIL

3.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, brought into force on 1st November 2016, require that all LGPS administering authorities draft an Investment Strategy Statement (ISS). Further, the Regulations require that this Committee should review the ISS from time to time and at least every three years. In the event of any material change to any matter contained within the ISS, changes will be reflected within six months of the change occurring. The Regulations require all Administering Authorities take 'proper advice' when formulating investment strategy. The Council is in the process of consulting suitably qualified persons and has obtained advice from its investment consultant, Mercer and consulted Hymans Robertson, the Scheme Actuary.

3.2 The Statement was reviewed most recently by this Committee at its meeting of 18th September, 2018 (Minute A50/18 refers).

3.3 This report represents the initial steps to a revised statement, reviewed to ensure compliance with the government guidance issued on 15th September 2016 and 12th July 2017. The Committee is invited to input into the process by offering any comment on the approach set out in tis report.

3.4 The current statement is attached to this report as Appendix A. The following paragraphs will consider changes to be incorporated in the revised statement.

3.5 References to advisors and fund managers will be updated to reflect current arrangements.

3.6 The Strategy considers six areas: Investment Objectives; Asset Allocation; Risk Management; Pooling; ESG and Voting. Investment Objectives will remain essentially unchanged. Asset allocation ranges may need to be revised in response to any reassessment of the Committee's risk appetite and the return assumptions agreed with the Scheme Actuary. Assuming no new asset classes are considered the section that provides information about the qualities of assets and how they contribute to the performance of the portfolio will remain substantially unchanged.

3.7 The risk management section will be revised to ensure that it is consistent with the current risk register.

3.8 The section on asset pooling and the London CIV can be updated to reflect the present status of the sub-funds and this Fund's engagement with the pooling agenda. This section will need to provide a link between principles adopted by this Committee and principles applied to investment choices.

3.9 The Environmental, Social and Corporate Governance (ESG) section will need to be drafted to ensure consistency with the Committee's views on these important issues: concerns about Environmental, Social and Corporate Governance factors. This Statement should specify that there should be an expectation that the Fund, (and by extension the London CIV), will seek to engage (through its asset managers or other resources) with companies to ensure they can deliver sustainable financial returns over the long-term. This would be particularly relevant for businesses in tobacco, aerospace and defence, and oil and gas. To illustrate this approach with the example of fossil fuels, this will mean engaging with oil companies on how they are assessing their business strategy and capital expenditure plans to adapt to changes in cost base and regulation that will ensure the continued delivery of shareholder returns of the medium to long term.

3.10 The section on Voting will be substantially unchanged.

4 FINANCIAL CONSIDERATIONS

4.1 There are no further financial considerations flowing from this report.

5. OTHER CONSIDERATIONS

5.1 Other than the considerations referred to above, there are no Customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report

6. COMMENTS OF THE SOLICITOR TO THE COUNCIL

6.1 The Head of Litigation and Corporate Law comments on behalf of the Director of Law and Governance that the provisions of Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 place the following requirements on the Administering Authority in relation to the Investment Strategy:

"7.—(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State.

(2) The authority's investment strategy must include:

(a) a requirement to invest fund money in a wide variety of investments;
(b) the authority's assessment of the suitability of particular investments and types of investments;
(c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;
(d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
(e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

(3) The authority's investment strategy must set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment.

(4) The authority's investment strategy may 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.

(5) The authority must consult such persons as it considers appropriate as to the proposed contents of its investment strategy.

(6) The authority must publish a statement of its investment strategy formulated under paragraph (1) and the first such statement must be published no later than 1st April 2017.

(7) The authority must review and if necessary revise its investment strategy from time to time, and at least every 3 years, and publish a statement of any revisions.

(8) The authority must invest, in accordance with its investment strategy, any fund money that is not needed immediately to make payments from the fund.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law, on behalf of the Director of Law and Governance and Monitoring Officer.

CONTACT OFFICER:

Nigel Cook, Head of Pensions Investment and Treasury,
Finance, Investment and Risk, Resources Department, ext. 62552.

BACKGROUND DOCUMENTS:

None.

Appendices

Appendix A: Investment Strategy Statement

Appendix A: Revised Investment Strategy Statement.

Investment Strategy Statement
(Effective 1 April 2017; Reviewed September 2018)

1 Introduction

1.1 The elected members of Croydon Council, acting through the Pension Committee, have drawn up this Investment Strategy Statement (ISS) as required by Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, brought into force on 1st November 2016. This statement is compliant with the government guidance issued on 15th September 2016 and 12th July 2017.

1.2 As set out in these Regulations, the Committee will review the ISS from time to time and at least every three years. In the event of any material change to any matter contained within the ISS, changes will be reflected within six months of the change occurring.

1.3 The Regulations require all Administering Authorities take ‘proper advice’ when formulating investment strategy. The Council has consulted suitably qualified persons and has obtained advice from its investment consultant, Mercer and consulted Hymans Robertson, the Scheme Actuary.

2 Investment Objectives

2.1 The Fund’s goal is to ensure there are sufficient assets to meet all liabilities as they fall due. In order to achieve this goal the Pensions Committee has adopted the following objectives:

2.1.1 Achieve a return on investments which at least meets the assumed return (the discount rate) used by the Actuary when setting the triennial valuation.

2.1.2 Keep risk within acceptable levels.

2.1.3 Maintain liquidity requirements to pay liabilities when they fall due.

2.2 The investment objectives align with the Funding Strategy Statement. This statement sets out the four key measures that the Actuary has developed which capture the essence of the Fund’s strategies, both the funding and this investment strategy. These include how much each employer can afford; and the question of stability, that is to say employers should not see significant moves in their contribution rates from one year to the next, to help provide a more stable budgeting environment. These objectives are often in conflict. In setting the Funding Strategy the Council has adopted a stabilisation approach that meets the need for stability of contributions without jeopardising the aim of prudent stewardship of the Fund.

3 Asset Allocation

3.1 In order to meet the Investment Objectives the Pensions Committee, in consultation with its Investment Adviser, has determined a suitable asset mix.

The Pension Committee’s interpretation of a suitable asset mix, is one which includes a variety of assets which are well understood, are less than perfectly correlated and which together are expected to meet the long term return objectives of the Fund. An asset mix which meets this criteria will be well diversified and improve the overall risk and return profile of the Fund increasing the likelihood of meeting the Investment Objectives. A properly diversified portfolio of assets should include a range of asset classes to help reduce overall portfolio risk. If a single investment class is not performing well, performance should be balanced by other investments which are doing better at that time. A diversified portfolio also helps to reduce volatility.

3.2 The Pensions Committee has identified four broad asset groups with the alternatives being split into four further classes. Cash is held as working capital and invested in Money Market Funds for short periods but is not considered as an investment asset, although fund managers may hold cash as part of their investment strategy. Desired targets and ranges have been assigned to each asset class. The holding in an asset class ought not to breach the upper end of the range. Table 1, below, sets out the maximum percentage of the total value of all investments of fund money that will be invested in each investments or class of investment. This replaces Schedule 1 to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (“the 2009 Regulations”).

Note that the Regulations require that this investment strategy must set out the maximum percentage of the total value of all investments of fund money that will be invested in particular investments or classes of investment. The Target Allocations set out above are aspirational and for guidance only because of the inevitable fluctuations caused by market volatility. The operational range reflects experience and current forecasts.

3.3 As a general principle Croydon Council will actively seek to identify how the Pension Scheme could contribute to and invest in the Borough.

Global Equities

3.4 The Pensions Committee has selected a passive global equity mandate managed solely by Legal and General Investment Management. The objective of the mandate is to track the L&G World Developed (Ex Tobacco) Index Fund. The reasons for this decision is to: reduce concentration risk by increasing the number of stocks covered for investment; achieve a reduction in management fee; and to move to a fund which is considered as fulfilling the criteria for the requirement to pool assets. In addition it is considered important to invest in a pooled arrangement to allow currency hedging to be implemented fairly easily and cheaply. The equity holdings are now considered part of the London CIV for pooling purposes (see section below for more details of the Fund’s strategy on asset pooling).

Fixed Interest

3.5 The Pensions Committee has appointed Standard Life and Wellington to manage its Fixed Interest allocation. Investments with Standard Life are in the Corporate Bond fund measuring performance against the Merrill Lynch non gilt sterling all stocks index and the Absolute Return fund measuring performance against 3 month LIBOR. Performance of the Wellington bond fund is measured against the Merrill Lynch Sterling Broad Market Index.

Traditional Property

3.6 The Pensions Committee has appointed Schroders to manage its traditional property portfolio, investing mainly in UK commercial real estate, with an objective to outperform the Investment Property Databank (IPD) All Properties Index.

Private Rental Sector Property

3.7 The Pensions Committee has appointed M&G to manage its Private Rental Sector property portfolio, with an objective to achieve a return of 7%.

Private Equity

3.8 Four Private Equity managers have been selected enabling the Fund to benefit from increased diversification through investments in a variety of companies in different markets. These managers are: Pantheon, providing access to funds of funds in Europe, US and Asia; Knightsbridge, investing in Venture Capital predominantly in the US; Access Capital Partners, a European co-investment fund; and North Sea Capital, providing exposure to markets in northern Europe and Scandinavia. The objective of this part of the portfolio is to generate returns in excess of the Consumer Prices Index (CPI) plus 5%.

Infrastructure

3.9 This asset class is represented by four asset managers that have been selected in order to gain cost effective, diversified exposure to global infrastructure assets. These managers comprise: Equitix that focus on UK PFI / PPP / PF2 contracts; Temporis and the Green Investment Bank that allow the Fund to access different types of renewables; and I Squared Capital, that provides opportunities across global infrastructure funds and projects. The investments seek to generate satisfactory risk adjusted return and provide a hedge against inflation. Some of the investments aim to be more growth seeking and some aim to be income generating. The overall return objective for this part of the portfolio is to generate returns in excess of the Consumer Prices Index (CPI) plus 5%.

Cash

3.10 The objective is to maintain capital and hold enough cash to meet ongoing benefit payments.

Assets' Features

3.11 Each of these asset classes possess features that, in combination, address the strategic goals for the Croydon Scheme. The authority's assessment of the suitability of particular investments and types of investments can be summarised thus:

Equities Over the log-run will deliver sufficient growth to address funding gap. Allows investment in wide range of sectors and geographic regions. Should beat inflation in the long run.
Fixed Interest Matches liabilities of the Fund. Demonstrates, in normal scenarios, negative correlation to equities. Absolute return portfolio should provide downside protection and is not dependent on direction of interest rates. Government and blue chip corporate debt is relatively low risk and provides protection against falling interest rates.
Property Does not correlate to equity or fixed interest. Provides steady cash flows. Provides some protection against inflation.
Private Equity Similar benefits to equity but at different points on the cycle. Regional diversification. Access to otherwise closed markets.
Infrastructure Diversification. Good spread of regions. Elements of regulated income. Mixture of growth and income generating assets. Income generating assets have an inflation link.

4 Risk Management

4.1 There are various risks to which any pension fund is exposed. The Pension Committee has considered a number of risks such as:

- The risk arising through a mismatch between the Fund’s assets and its liabilities.
- The risk of deterioration in the Fund’s ongoing funding level.
- The risk that the day-to-day management of the assets will not achieve the rate of investment return required to meet accrued and future liabilities as quantified by the Fund’s Actuary.
- The risk that volatility resulting from various geopolitical factors will have an adverse effect on the long-term viability of the Fund. This risk is increased by having a majority of the fund under passive management.
- Exchange rate risk arises from investing in unhedged overseas assets with all liabilities due to be paid in sterling. As a long-term investor such volatility can be tolerated. The extent to which the Fund is diversified across asset classes, geography and approach to investments works to mitigate this risk.
- The risk of insufficient liquidity from the Fund's assets.

4.2 In order to mitigate the risks identified the Pensions Committee formulated the asset allocation having taken proper advice from its investment adviser. Various scenarios were tested and the probability of achieving full funding over a specified period of time was calculated in order to identify an asset mix which should fulfil the objectives. The main way to mitigate risk of the investment portfolio not achieving its objectives is through diversification of assets. This should provide protection in periods of market turmoil as some assets will preserve capital better than others and in rising markets some assets will perform better than others.

4.3 Risks specifically relating to the Pension Fund are included in a risk register that is regularly reviewed by both the Pension Committee (which considers the most significant risks) and the Croydon Pension Board (which looks at all the risks). The most immediate and significant risks are also included in the corporate risk register. Steps to mitigate risks in the short and longer-term are included in the register.

4.4 The Pension Fund's appetite for risk, in so far as generating returns is concerned, should be only that much as is sufficient to meet the return target set by the Funding Strategy Statement. Other risks should be mitigated as far as is possible.

4.5 The Pensions Committee constantly monitors the performance of managers to ensure the Fund's objectives are met.

5 Pooling of Assets

5.1 The Fund participates in the London Collective Investment Vehicle (CIV) as part of the Government's pooling agenda. Croydon is a shareholder, contributes regulatory capital and a subscription fee. The London CIV was launched in December 2015. It has launched a number of sub-funds comprising: UK, Global and Emerging Market equities; Multi-Asset and Fixed Interest Funds.

5.2 The Fund is monitoring developments and the opening of investment strategy fund openings on the London CIV platform. At present there are options for participating in pooling: including transitioning liquid assets across to the London CIV as soon as there are suitable sub-funds available to meet the Fund's investment strategy requirements; investing in sub-funds that meet the requirements of the Fund's investment strategy; and investing in assets that have been deemed part of the pooling strategy but which are assets that are not suitable for pooling in an ACS structure.

5.3 The Fund holds illiquid assets outside of the London CIV pool. The cost of exiting these strategies early would have a negative financial impact on the Fund. These will be held as legacy assets until such time as they mature. The Fund will continue to invest in illiquid assets outside of the London CIV pool, until suitable strategies are made available by the London CIV pool, in order to meet its asset allocation target.

5.4 Therefore, the proportion of assets that will be invested through the pool will be circa. 65%, depending on valuations. At year-end 2017/2018 51% of the Pension Fund should be considered pooled.

5.5 In establishing the framework for asset pooling the government recognised that investing in illiquid assets like infrastructure, direct holdings in property and locally targeted investments might more appropriately sit outside the pooling arrangements. The alternative asset classes listed above, property, private equity and infrastructure, are included in this group.

6 Environmental, Social and Corporate Governance (ESG)

6.1 The Fund is committed to being a long term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. In addition the Pensions Committee undertakes training on a regular basis and this will include training and information sessions on matters of social, environmental and corporate governance.

6.2 The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It expects its managers to follow good practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed.

6.3 The Fund will only invest in investments with a strong environmental, social and governance policy that includes no tobacco investments. The Fund will disinvest from existing fossil fuel investments in a prudent and sensible way that reflects the fiduciary responsibility due to stakeholders. Furthermore, where this is consistent with the agreed investment strategy, the Fund will invest in assets that positively address these issues. Examples of this approach include investing in renewable energy projects, screening out regional markets where there might be issues with modern slavery, and looking to explore opportunities to contribute to and invest in the Borough.

6.4 The Fund expects its external investment managers (and specifically the London CIV through which the Fund will increasingly invest) to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the fund such as corporate governance and environmental factors. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making.

6.5 Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

6.6 The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

6.7 The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors to the extent these directly or indirectly impact on financial risk and return.

6.8 The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

7 Voting

7.1 The Fund recognises the importance of its role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Fund recognises that ultimately this protects the financial interests of the Fund and its ultimate beneficiaries. The Fund has a commitment to actively exercising the ownership rights attached to its investments reflecting the Fund’s conviction that responsible asset owners should maintain oversight of the companies in which it ultimately invests recognising that the companies' activities impact upon not only their customers and clients, but more widely upon their employees and other stakeholders and also wider society.

7.2 The Fund has delegated responsibility for voting rights to the Fund's external investment manager, currently LGIM, and expects them to vote in accordance with the Fund's voting policy.

7.3 The Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the Pension Fund website.

7.4 The Fund has not issued a separate Statement of Compliance with the Stewardship Code, but fully endorses the principles embedded in the seven Principles of the Stewardship Code.

7.5 The Fund expects its external investment managers to be signatories of the Stewardship Code and reach Tier One level of compliance or to be seeking to achieve a Tier One status within a reasonable timeframe. Where this is not feasible the Fund expects a detailed explanation as to why it will not be able to achieve this level.

7.6 In addition, the Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly.

7.7 The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which invests.

7.8 In addition the Fund:

- Is a member of the Local Authority Pension Fund Forum (LAPFF) and in this way joins with other LGPS Funds to magnify its voice and maximise the influence of investors as asset owners;
- is a member of the Pension and Lifetime Savings Association (PLSA) and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners;
- Joins wider lobbying activities where appropriate opportunities arise.