CYNGOR Sir y Fflint
Flintshire
COUNTY COUNCIL

CLWYD PENSION FUND COMMITTEE

Date of Meeting	Thursday, 28 November 2019
Report Subject	Review of Investment Strategy and Responsible Investment Policy
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

The Fund is in the process of completing the 31 March 2019 triennial Actuarial Valuation, and as a result it is appropriate to review the Strategic Asset Allocation, to ensure it remains suitable for the on-going requirements. It is also important to consider the current global economic environment when reviewing Investment Strategy.

The Fund's Investment Consultant has reviewed the Strategic Asset Allocation, and after a number of discussions with Officers the proposed Strategy is presented to the Committee for agreement. This report will be supplemented by a presentation at the meeting from the Fund's Investment Consultant which will consider, in more detail, the process followed and outcomes.

This report contains the proposed Strategic Asset Allocation at paragraph 3.02 and a summary of the key changes in paragraph 3.04.

In addition to reviewing the Strategic Asset Allocation, the Fund has been reviewing its Responsible Investment (RI) policy, which has been developed after considering the views of the Committee expressed through the survey and following discussions at the meeting in September 2019. The revised Policy is contained within the appendix and contains three key areas:

- RI Principles
- Climate Change
- Strategic RI Priorities.

The priorities section is particularly pertinent as it covers the key focus for the Fund's work on RI for the next three years.

RECOMMENDATIONS	
1.	To agree the proposed Strategic Asset Allocation (as shown in paragraph 3.02) of the Fund as a basis for consultation with the Fund's Employers.
2.	To consider and agree the Responsible Investment Policy as the basis for consultation with the Fund's Employers.

REPORT DETAILS

1.00	REVIEW OF STRATEGIC ASSET ALLOCATION
1.01	**Background** Every three years the Fund's Actuary calculates the Assets and Liabilities of the Fund to establish its Funding position, and perhaps more crucially to calculate the Employers' contribution rates for the coming period. In conjunction with this process the Fund's Strategic Asset Allocation is reviewed to ensure that it is appropriate and is likely to deliver the required level of return at an acceptable level of risk. When undertaking the Valuation the Fund, the Actuary makes a number of key assumptions which were presented to the Committee in September 2019. These assumptions include a required rate of investment return. For the 2019 Valuation the Actuary has assumed a rate of return of Inflation (measured by the Consumer Prices Index (CPI)) +1.75% for past service and Inflation or CPI +2.25% for future service. It is therefore crucial that the Investment Strategy achieves a return in excess of this future service rate of CPI +2.25%.
1.02	The Fund last refreshed its Investment strategy in 2016, was implemented over the following years. The last review was only a "light-touch" assessment given its closeness to the previous review undertaken in 2014. As three years have passed since this review it is now appropriate to review and refresh the Fund's Strategic Asset Allocation.
1.03	The Fund's Officers have been working closely with the Fund's Investment Consultant and have established a work programme to undertake the necessary assessment to enable a presentation to be made to the Committee today with a recommended strategy for the Fund. The timeline is contained as an Appendix to this report.

2.00	**PROCESS**
2.01	As can be seen in the review timeline attached in the Appendix the process started with Officers in July, and has involved a number of meetings since to consider a number of factors involved in setting the long term Strategic Asset Allocation. In addition to this work with the Fund's Officers, a training day was held for the Committee on 7 October 2019 to provide the background to the Fund's current Strategy, its asset classes and the process for the review. The presentation that will support this report at the Committee meeting will take the Committee through the process in some detail.
2.02	As discussed at the training day with the Committee and throughout the discussions with Officers the desired outcomes of this process were to set a long term Strategic Asset Allocation for the Fund that will: deliver the level of returns required by the Fund's Actuary, and; • do this at an acceptable level or risk, and; • where possible seek to reduce the overall level of Investment Management fees paid by the Fund.
2.03	The additional consideration that was key to this review was the role of the Wales Pension Partnership in the implementation of the Fund's strategy. Whilst pooling should not and does not affect the Committee's responsibility to set the Strategic Asset Allocation, it does need to be a consideration when assessing the practical aspects of implementing the strategy.

3.00	**OUTCOMES**
3.01	After the analysis that was undertaken by the Fund's Investment Consultant with the Officers a revised strategy was discussed and agreed for presentation to the Committee today. The presentation from the Fund's Investment Consultant at the meeting will cover more detail of the recommended new strategy. The following paragraphs show the strategy and comment on the changes.
3.02	The table below shows the Strategic Asset Allocation being recommended to the Committee today, and highlights changes from the current position.

Asset Class	Current Strategic Allocation	Proposed Strategy	Change
Developed Global Equity	8.0%	10.0%	+2.0%
Emerging Market Equity	6.0%	10.0%	+4.0%
Diversified Growth	10.0%	-	-10.0%
Hedge Funds	9.0%	7.0%	-2.0%
TAA/Best Ideas	11.0%	11.0%	-
Multi Asset Credit	12.0%	12.0%	-
Property	4.0%	4.0%	-
Private Equity	10.0%	8.0%	-2.0%
Local/Impact	-	4.0%	+4.0%
Infrastructure	8.0%	8.0%	-
Private Credit	3.0%	3.0%	-
Cash & Risk Management Framework	19.0%	23.0%	+4.0%
Total	**100.0%**	**100.0%**	

3.03 The Fund's Investment Consultant has estimated, based on long term market forecasts that the new strategy will deliver a long term (10 year) return of 5.6% per annum, compared to the existing strategy which delivers an estimated 5.4% per annum. This forecast return of 5.6% (or CPI +3.4%) is comfortably ahead of the Actuary's required rate of return of CPI +2.25%.

In addition to the potential for investment return the Fund's Investment Consultant also looks to assess the risk of the proposed strategy when compared to the current. Risk is assessed using a Value at Risk (VaR) approach: VaR is a measure of the risk of loss for investments. It estimates how much a set of investments might lose (with a given probability), given normal market conditions, in a set time period such as a day or a year.

In Clwyd's case the Fund's Investment Consultant has assessed that the Fund's current strategy has a 95% one year deficit VaR of £437.9m; meaning that there is a 95% chance that over any one year the Fund's deficit will not fall by more than £437.9m. The proposed strategy has a marginally higher one year deficit VaR of £444.6m. When compared to the current actual allocation, the proposed strategy has the potential to achieve +0.1% higher return at lower risk.

The result of this analysis is that the new strategy has a higher potential return than the current strategy at a marginally higher risk, albeit lower risk than the current actual position. The Fund's Investment Consultant will cover this in more detail in the presentation.

3.04 The key changes are detailed in the following paragraphs:

Removal of allocation to Diversified Growth Funds (DGF).
DGF's seek to tactically deploy capital across a number of asset classes to enable investors to achieve equity like returns at lower levels of volatility.

	However in recent years the Fund's experience has not been good, and the performance across the DGF universe has been poor. In addition the Fund has other ways to invest tactically, such as the Best Ideas portfolio. The overall diversification within the total Fund also leads to a less compelling case to invest in DGFs. **Increase allocation to Global and Emerging Market Equities** This change is linked to the decision to remove the DGF allocation, due to the DGF's having an underlying allocation to equity. The increased allocation is therefore, at least in part designed to replace this. In addition the Fund's consultant believes that in the longer term Emerging Market equities will offer the potential for higher returns than Developed Global Equity. The Fund will also switch its Smart Beta investment with BlackRock into a Low Carbon ESG portfolio to support the Fund's proposed Responsible Investment objectives (detailed later in this report). **Reduce Strategic weight, and restructure Hedge Fund allocation** The current allocation to Hedge Funds is around 7% of the total Fund compared to the existing strategic benchmark weight of 9%. Given the performance that the Fund has seen in recent years, plus the wider investment allocations that the Fund has, the new strategy has a reduced strategic weight of 7%. In addition, since the mandate was originally designed, the Fund's Risk Management Framework has evolved to cover a number of areas. It is appropriate therefore to consider restructuring the underlying arrangements to reflect the potential role for a Hedge Fund strategy in the context of the future uncertain market environment. **Creation of an explicit Local/Impact portfolio** The Committee will be aware of the allocations within the Fund's In-House Private Markets to investments that are seeking to make a positive contribution to the Environment or Society more widely whilst still making an appropriate level of investment return. This change to the strategy explicitly creates an allocation to this area, and will enable the Fund to continue to make these specific investments, and effectively support society with its investments. This allocation is funded in part by a reduction in the Strategic weight for Private Equity; however this includes a number of existing investments that have been identified to form the basis for the new portfolio. **Increase allocation to Cash and Risk Management Framework** This framework has been in place for a number of years and has evolved in a number of ways to help the Fund effectively manage its investment risks. Over time the valuation of the portfolio has increased and as such it has moved to an overweight position versus the Strategic weight. It is not appropriate to look to reduce this, in particular as it is now envisaged that this allocation will also be used to control the Fund's cash-flow requirements (both to meet benefits payments and fund private markets capital calls) so this move effectively brings the Strategic weight in line with the actual position.
3.05	The paragraphs above detail the potential to meet two of the objectives of the review, to increase the potential return whilst lowering the risk; the final objective was to seek to reduce overall investment management costs.

Whilst this objective was not the main focus of the review it was rightly an important consideration given the objectives of the pooling agenda to also reduce overall fee levels.

3.06 The table below shows the potential for reduced fees both as a result of the changes to the strategy and the changes to implementation (either by investing through the WPP or restructuring the portfolio). Due to sensitivity around fee levels for specific mandates it is not possible to report exact number for each asset class, but the table shows where changes are expected to be achieved, and give an overall level of saving for the Fund. The table shows that it is estimated fee savings will be in the range £1.8 - £2.5m per year for the Fund. There are a number of factors that make it difficult to be more accurate than this, and these can be explained in the presentation on the day.

Asset Class	Proposed Strategy	Change in Investment Management Fees	
		Strategy	Implementation
Developed Global Equity	10.0%	☒	☑
Emerging Market Equity	10.0%	☒	☑
Diversified Growth	-	☑	-
Hedge Funds	7.0%	☑	☑
TAA/Best Ideas	11.0%	-	-
Multi Asset Credit	12.0%	-	☒
Property	4.0%	-	-
Private Equity	8.0%	☑	-
Local/Impact	4.0%	☒	-
Infrastructure	8.0%	-	-
Private Credit	3.0%	-	-
Cash & Risk Management Framework	23.0%	☒	-
Potential fee savings		£1.8 - £2.5 Million per annum	

4.00 RESPONSIBLE INVESTMENT

4.01 The Committee has had a number of training sessions in 2019 focussing on Responsible Investment (RI). This culminated in a session at the meeting in September to establish the Committee's beliefs to enable the Fund's policies to be revised. This process took place concurrently with the review of the Strategic Asset Allocation deliberately to allow the results to be reflected and implemented in the new Strategy.

4.02	As a result of the Committee survey and session in September the Fund's Investment Consultant has worked with Officers to develop a new RI policy. The proposed policy is attached as an Appendix to this report.
4.03	The new RI Policy communicates the Fund's beliefs and approach to being a Responsible Investor. The Policy contains three distinct areas: • **RI Principles** – those beliefs which drive the Fund's thinking • **Climate Change** – specific beliefs relating to Climate Change • **Strategic RI Priorities** – the focus for the Fund's approach to RI over the next three years. Each of these areas is covered in more detail in the following paragraph.
4.04	**RI Principles** This section of the Policy lists eight overarching principles which drive the Funds RI thinking. It includes such areas as the Fund's fiduciary duty, its beliefs around stewardship (voting and engagement) and its approach to Social/Impact investments. **Climate Change** The engagement with the Committee highlighted that, of all of the specific focuses that being a responsible investment encompasses, Climate Change and environmental considerations were the most important. This section covers the Fund's approach to considering Climate Change and highlights some of the risks and opportunities that it presents to investors. **Strategic RI Priorities** It is important, when considering an approach to RI not to try to achieve everything at once. Being a responsible investor can be quite daunting given the numerous things that can be considered, and it is important therefore to focus the Fund's approach to certain key areas. This section highlights the five areas that the Fund has identified as its key priorities over the three years 2020-2023.

5.00	**CONSULTATION**
5.01	The LGPS Investment regulations require that the Fund "consults with such persons as it considers appropriate as to the proposed contents of its investment strategy". The Fund intends to seek the views of its employers This will include the Responsible Investment policy. The topic of Responsible Investment is very high profile at the moment, and the Fund's employers had a presentation on the subject at the recent Annual Joint Consultative Meeting.

6.00	**INVESTMENT STRATEGY STATEMENT**
6.01	The final piece of work once the Strategy is agreed and consulted on is to revise the Fund's Investment Strategy Statement (ISS). The ISS contains,

	amongst other things, the revised Strategy and the RI policy. It is proposed therefore that once the Fund has the results of its consultation the ISS will be revised and presented to the next meeting of the Committee in February 2020 for approval.

7.00	**RESOURCE IMPLICATIONS**
7.01	As a result of the revised Strategy and implementation the Fund has the potential to save between £1.8m and £2.5m per annum in Investment Management costs.

8.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
8.01	The Fund will consult with the Employers and the Committee is asked to consider whether to widen this consultation to the Fund's members.

9.00	**RISK MANAGEMENT**
9.01	The Fund's investment strategy has been designed to provide an appropriate trade off between risk and return. The Fund faces three key investment risks: Equity risk, Interest Rate Risk and Inflation Risk. Diversification of the Fund's growth assets away from equities seeks to reduce the amount of the equity risk (though it should be recognised that Equities remain an important long term source of expected growth). The implementation of the Fund's De-Risking Framework (Flightpath) has been designed to mitigate the Fund's Interest Rate and Inflation Risks.

10.00	**APPENDICES**
10.01	Appendix 1 – Investment Strategy Review timeline Appendix 2 – Responsible Investment Policy

11.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
11.01	N/A **Contact Officer:** Philip Latham, Head of Clwyd Pension Fund **Telephone:** 01352 702264 **E-mail:** philip.latham@flintshire.gov.uk

12.00	GLOSSARY OF TERMS
12.01	A list of commonly used terms are as follows: (a) **Absolute Return –** The actual return, as opposed to the return relative to a benchmark. (b) **Annualised –** Figures expressed as applying to 1 year. (c) **Duration –** The weighted average time to payment of cashflows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields. (d) **Market Volatility –** The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change and inflation impact. (e) **Money-Weighted Rate of Return –** The rate of return on an investment including the amount and timing of cashflows. (f) **Relative Return –** The return on a fund compared to the return on index or benchmark. This is defined as: Return on Fund minus Return on Index or Benchmark. (g) **Three-Year Return –** The total return on the fund over a three year period expressed in percent per annum. (h) **Time-Weighted Rate of Return –** The rate of return on an investment removing the effect of the amount and timing of cashflows. (i) **Yield (Gross Redemption Yield) –** The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the value of future cash-flows. (j) **Value at Risk (VaR)** - a measure of the risk of loss for investments. It estimates how much a set of investments might lose (with a given probability), given normal market conditions, in a set time period such as a day. **A comprehensive list of investment terms can be found via the following link:** https://www.schroders.com/en/uk/adviser/tools/glossary/