Nottinghamshire County Council

Nottinghamshire Pension Fund

April 2019

INVESTMENT STRATEGY STATEMENT

Introduction

1. The County Council is an administering authority of the Local Government Pension Scheme (the “Scheme”) as specified by the Local Government Pension Scheme Regulations 2013 (“the LGPS Regulations”). It is required by Regulation 53 of the LGPS Regulations to maintain a pension fund for the Scheme.

2. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the “Investment Regulations”) govern the management of the pension fund and the investment of fund money. According to Regulation 7 of the Investment Regulations an administering authority must formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State. It must publish a statement of its investment strategy and must review, and if necessary revise, its investment strategy at least every three years.

3. The investment strategy statement 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.
    f) The authority’s policy on the exercise of the rights (including voting rights) attaching to investments.

Purpose and Principles

4. The purpose of the Fund is to:
    - Pay pensions, lump sums and other benefits provided under the LGPS Regulations.
    - Meet the costs associated in administering the Fund.
    - Receive contributions, transfer values and investment income.
    - Invest any Fund money not needed immediately to make payments.

5. The following principles underpin the Fund’s investment activity:
    - The Fund will aim to be sufficient to meet all its obligations on a continuing basis.
    - The Fund will be invested in a diversified range of assets.
    - Proper advice on diversification and the suitability of types of investment will be obtained and considered

- The Fund will aim to conduct its business and to use its influence in a long term responsible way.

Key Parties

6. The key parties involved in the Fund's investments and their responsibilities are as follows.

The Administering Authority

7. The Administering Authority for the Pension Fund is Nottinghamshire County Council. Under the terms of the Council's constitution, the functions of the Council as administering authority are delegated to the Nottinghamshire Pension Fund Committee. The full governance arrangements of the Fund are detailed in the Fund's Governance Compliance Statement.

8. The members of the Committee are not trustees (as the LGPS is a statutory scheme) but do have fiduciary duties towards the scheme members and employers.

LGPS Central

9. LGPS Central ("the Pool") is the asset pool which Nottinghamshire Pension Fund jointly owns with seven other LGPS funds in order to meet the government's criteria for investment reform issued in November 2015. The Pool has obtained FCA regulation and manages collective investment vehicles on behalf of the participating funds.

Committee Members

10. The Committee Members recognise their full responsibility for the oversight of the Fund, and operate to a Code of Conduct. They shall:
    - Determine the overall asset allocation and investment strategy of the Fund.
    - Determine the type of investment management to be used and, until funds are transferred to the Pool, appoint and dismiss fund managers.
    - Receive regular reports on performance from the main fund managers and question them regularly on their performance.
    - Receive independent reports on the performance of fund managers on a regular basis.
    - Be encouraged to receive suitable training to help them discharge their responsibilities and attend such training courses, conferences and meetings that deliver value for money to the Fund.

Chief Finance Officer

11. Under the Council's constitution, the Service Director (Finance, Infrastructure & Improvement) is designated the Council's Chief Finance Officer (also known as the Section 151 Officer). The Group Manager (Financial Services) is the deputy Section 151 Officer. Financial Regulations specify that the Section 151 Officer is responsible for arranging the investment of the Pension Fund. Operational matters falling under this responsibility are exercised by the Senior Accountant (Pensions & Treasury Management).

12. Authorised signatories for operational matters relating to pension fund investments are:
    - Service Director (Finance, Infrastructure & Improvement)
    - Group Manager (Financial Services)
    - Senior Accountant (Pensions & Treasury Management)
    - Investments Officer

13. Representatives of the Service Director (Finance, Infrastructure & Improvement) provide advice to Committee members and attend meetings of the Pension Fund Committee as required.

Independent Adviser

14. The Fund has an Independent Adviser who attends meetings of the Pension Fund Committee and Pensions Working Party as required. This is considered best practice in accordance with the requirements for "proper advice" in the governing regulations. The Independent Advisor is appointed by the Administrating Authority following appropriate consultation with the Committee.

15. The independent adviser is engaged to provide advice on:
    - The objectives and policies of the Fund.
    - Investment strategy and asset allocation.
    - The Fund's approach to responsible investment.
    - Choice of benchmarks.
    - Investment management methods and structures.
    - Choice of managers and external specialists.
    - Activity and performance of investment managers including the Pool and the Fund.
    - The risks involved with existing or proposed investments.
    - The Fund's current property portfolio and any proposals for purchases, sales, improvement or development.
    - New developments and opportunities in investment theory and practice.
    - Amendment and review of statutory policy documents.

Asset Allocation

16. It is widely recognised that asset allocation is the most important factor in driving long term investment returns. The balance between different asset classes depends largely on the expected risk/return profile for each asset class and the target return for the Fund. It is also recognised that investment returns play a significant role in defraying the cost of providing pensions by mitigating the contributions required from employers.

17. Employers contributions are determined as part of the regular actuarial valuation of the Fund. Historically these have taken place every three years and a valuation is taking place as at March 2019. Going forward, they are expected to take place every four years. The actuarial valuation involves a projection of future cash flows to and from the Fund. Its main purpose is to determine the level of employers' contributions that should ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund. This is the main funding objective as set out in the Funding Strategy Statement.

18. The Fund Actuary estimates the future cash flows which will be paid from the Fund for the benefits relating to service up to the valuation date. They then discount these projected cash flows using the discount rate to get a single figure for the value of the past service liabilities. This figure is the amount of money which, if invested now, would be sufficient to make these payments in future provided that the future investment return was equal to at least the discount rate used.

19. The discount rate is based on the expected long term future investment returns from various asset classes. These are likely to be adjusted following the March 2019 valuation, but are currently as follows:

Asset class	Expected return (p.a.)
Equities	7.4%
Gilts	2.4%
Other bonds	3.3%
Property	5.9%
Cash	1.8%
Discount rate	**5.4%**
Fund Target Return	**6.0%**

20. At the March 2016 valuation, the Fund was assessed to have a deficit of £621m and a funding level of 87%. Deficit recovery contributions have been certified for the majority of employers but any returns in excess of the discount rate will help to recover the Fund to a fully funded position. The Fund therefore sets its asset allocation to target an annual return rate of 6%. These figures and the asset allocation may need to be reviewed when the results of the March 2019 valuation are known.

21. The agreed asset allocation ranges for the Fund are shown below, along with the Fund's long term strategic target allocations.

Asset class	Allocation ranges	Strategic benchmark	
Equities	55% to 75%	FTSE All Share World	68%
Property	5% to 25%	IPD annual	15%
Bonds	10% to 25%	FTSE UK All Stock	15%
Cash	0% to 10%	LIBID 7 Day	2%

22. This asset allocation is aimed at achieving appropriate returns to meet the Fund Target Return within acceptable risk parameters. The Fund's actual allocation may vary from this according to market circumstances, relative performance and cash flow requirements. The ranges will be kept under regular review and, if it appears likely that these limits might be breached because of market movements, reference will be made to a meeting of the Pensions Working Party for advice.

23. The asset allocation currently favours "growth" assets, primarily equities, as they are expected to deliver higher returns to help the Fund achieve the Fund Target Return. Net additions from members (contributions received less benefits paid) are now expected to be negative for the foreseeable future, so the Fund also invests in "income" assets which will deliver secure and predictable income over the long term. These may include infrastructure, property and fixed income. Inflation is a long-term risk factor and the Fund explicitly seeks investments in this category which will help to mitigate that. Finally, the Fund allocates to liquid assets such as cash and short-term bonds in order to ensure cash is always available to pay benefits at any time. This allows the Fund to continue to implement a long-term investment strategy.

24. The asset allocation is regularly reviewed to consider whether it is appropriate to change the mix of growth versus income assets.

Investment Strategy

Requirement to invest fund money in a wide variety of investments

25. In setting asset allocation to deliver the Fund Return Target the Fund will seek as far as possible to invest in a diversified range of uncorrelated assets in order to reduce the level of investment risk.

Types of investments

26. Subject to the LGPS regulations on allowable investments the Fund may invest in a wide range of assets and strategies including quoted equity, government and non-government bonds, currencies, money markets, commodities, traded options, financial futures and derivatives, alternative strategies, private equity and debt markets, infrastructure and property. Investment may be made either in-house, indirectly (via funds) in physical assets or using derivatives, or through external managers including the Pool. The fund may use external managers to carry out stock lending ensuring suitable controls/risk parameters are put in place to prevent losses. Where an asset class/strategy is not expected to help in delivering the risk adjusted investment return required it will not be held.

Approach to investment

27. The Fund bases its approach to investment on the investment beliefs set out in Appendix A. As the Pool takes over implementation of the investments, some of them will become less relevant to the Pension Fund Committee's decisions but they should be seen as the fundamental core of how the Fund's assets are invested.

Approach to risk, including the ways in which risks are to be assessed and managed

28. The risk tolerance of the Fund is agreed with the Pension Fund Committee, the investment team and independent adviser through the setting of investment beliefs, funding and investment objectives. The Fund will only take sufficient risk in order to meet the Fund Target Return set out in paragraph 19, currently 6%.

29. The risks the Fund is exposed to include investment, operational, governance, currency, demographic and funding risks. These risks are identified, measured, monitored and then managed. This is carried out using risk registers with section responsibility and oversight from the Head of Governance and Chief Risk Officer. Plans are put in place to mitigate these risks so far as that is possible. Details are given in Appendix B.

Approach to pooling investments

30. The Fund is entering the Pool with the understanding that the pooled investments will benefit from lower investment costs, greater investment capability, improved ability to act as a responsible investor and access to more uncorrelated asset classes. Becoming an FCA registered investment manager is expected to lead to improved governance, transparency and reporting giving the Pension Fund assurance that its investment strategy is being carried out effectively.

31. It is expected that most of the Fund's assets will be transferred to the Pool over a period of time. The Pool is setting up sub-funds which the Fund and other partners expect to invest in.

It is likely that this process will take place over a period of at least two or three years, with the timing being dependent on market conditions and operational circumstances. Where there are financial or other barriers to transfers, assets may remain in the Fund's ownership.

32. Governance of the Pool will primarily take place through the Shareholders Forum, governed by a Shareholders Agreement and operating under company law, which will have formal decision making powers. Nottinghamshire County Council will have equal voting rights alongside the other participating funds and unanimous decisions will be required on key strategic matters. These are specified in the Shareholders Agreement and Articles of Association, and include the appointment and dismissal of the company's senior executives, approval of the company's strategic plan and any significant financial transactions, such as major acquisitions, lending or borrowing.

33. The degree of control to be exercised by the Shareholders through their reserved powers will be greater than is generally the case, in order to satisfy the Teckal exemption criteria and allow the company to undertake services on behalf of the investor funds without a formal procurement process.

34. The Joint Committee, established by an Inter-Authority Agreement, will be the forum for dealing with common investor issues and for collective monitoring of the performance of the pool against the agreed objectives of the Pool. It will, however, have no formal decision-making powers and recommendations will require the approval of individual authorities, in accordance with their local constitutional arrangements.

35. The government has made clear their expectation that pooled entities should be regulated by the Financial Conduct Authority (FCA) to ensure appropriate safeguards over the management of client monies. As such the Pool will be subject to ongoing oversight by the FCA and those holding key management positions, including the company directors, need to be approved persons, able to demonstrate appropriate knowledge, expertise and track record in investment management. The Directors of the Pool will also be personally liable for their actions and decisions.

36. Comprehensive programme governance arrangements are in place to ensure that costs and savings are managed in accordance with the agreed business case. The Section 151 Officers of each of the participating funds sit on the LGPS Practitioners Advisory Forum and regular meetings are held with the Chair and Vice-Chair of the Pension Fund Committee to ensure effective member oversight of progress and delivery. The Nottinghamshire Pension Fund Committee and the Local Pension Board are also being updated regularly on key developments and decisions.

37. Expert advisers have been appointed to provide support on legal matters, FCA registration, taxation and overall programme management.

Assessment of the suitability of investments

38. The policy of the Fund will be to treat the equity allocation as a block aimed at maximising the financial returns to the funds (and thus minimising employers' contributions) consistent with an acceptable level of risk. Other investments, such as property, fixed income, infrastructure or cash are aimed at mitigating risks which the Fund are exposed to, such as inflation, cashflow shortage, interest rate changes etc.

39. The Trustees have agreed an allocation to private equity and infrastructure. The allocation is based on committed amounts and, owing to the nature of these vehicles, the actual net investment level may be lower, perhaps significantly so. New investments will be made over time to target a commitment level of 12% of the Fund (within an allocation range up to 15% to allow for movements in market value).

40. Cash will be managed and invested on the Fund's behalf by the County Council in line with its treasury management policy. The policy is to invest surplus funds prudently, giving priority to security and liquidity rather than yield. If losses occur, however, the Fund will bear its share of those losses.

41. Pension fund cash is separately identified in a named account and specific investment decisions will be made on any surplus cash identified, based on the estimated cash flow requirements of the Fund. As the majority of cash is allocated to individual investment managers and may be called by them for investment at short notice, it is expected that the majority of cash will be placed on call or on short-term fixed deposits. Unallocated balances may be placed directly with the Fund's custodian.

Policy on social, environmental and corporate governance considerations

42. Social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments. Non-financial factors may be considered to the extent that they are not significantly detrimental to the investment return and the Committee is satisfied that members share their concerns.

43. It is recognised that Environmental, Social, and Governance ("ESG") factors including climate change are important to long term investment performance and the ability to achieve long term sustainable returns. The Pension Fund Committee considers the Fund's approach to ESG in three key areas:
    a. Selection – considering the financial impact of ESG factors on its investments.
    b. Stewardship – acting as responsible and active owners, through considered voting of shares and engaging with investee company management as part of the investment process. The Committee supports the Stewardship Code and intends to become a signatory.
    c. Transparency & Disclosure – commitment to reporting the outcomes of the Fund's stewardship activities.

44. In combination these three matters are often referred to as "Responsible Investment" or "RI" and this is the preferred terminology of the fund. Effective management of financially material ESG risks should support the requirement to protect investment returns over the long term. The Committee bases its decisions in this area on its RI Investment Beliefs, which are set out within Appendix A.

45. The Pool has a fully developed set of RI policies, which are in line with the Committee's own investment beliefs. This includes a *Responsible Investment & Engagement Framework*, a *Statement of Compliance with the UK Stewardship Code*, and *Voting Principles*. The Fund, through the Pool's Practitioners Advisory Forum, contributes to the development of these policies. As the Fund transfers assets to it, the Pool will take responsibility for ensuring that underlying managers meet with the requirements of this policy. The Pool will also engage directly with investee companies to promote sustainable business practices that reward long-term investors. Voting rights associated with assets invested through the Pool's subfunds will be instructed according to the Pool's agreed *Voting Principles*. The Pool will be required to

report on its RI policy to the Committee on a regular basis in order to demonstrate the implementation of the agreed RI policies.

46. The Fund has articulated an investment belief on the relevance of climate change for financial markets (see Appendix A). In line with this belief, the Fund will actively look for investments which can be expected to benefit as a result of the long-term impacts of climate change.

Policy on the exercise of the rights (including voting rights) attaching to investments

47. Membership of the Local Authority Pension Fund Forum (LAPFF) helps Nottinghamshire Pension Fund to engage with companies to understand issues and to promote best practice. LAPFF was set up in 1990 and is a voluntary association of the majority of Local Authority pension funds based in the UK with combined assets of over £200bn. It exists to protect the long term investment interest of local authority pension funds, and to maximise their influence as shareholders by promoting the highest standards of corporate governance and corporate responsibility amongst investee companies.

48. The Committee believes that voting is an integral part of the responsible investment and stewardship process. The Fund manages its ownership responsibilities through both its partnership with Pensions & Investment Research Consultants Ltd (PIRC) and via its investment managers. PIRC is a major independent corporate governance and shareholder advisory consultancy. PIRC exercises all the Funds voting rights in line with the PIRC proxy voting guidelines.

49. The Pool is a Tier 1 signatory to the Stewardship Code and it is the Fund’s aspiration to follow suit.

50. PIRC reports quarterly on its voting activity, and these reports are available to Committee Members and the membership through the website. The availability of this information is stated in the Annual Report.

Other Issues

51. The Fund’s assets are held in custody by a combination of an independent custodian, investment managers and in-house. The performance of fund managers will be measured against individual benchmarks and the overall fund, including cash returns, against the Fund Target Return. Performance will be measured by an independent agency. The statement of accounts will be audited by the County Council’s external auditors.

52. The investment management arrangements of the Fund can be found in the latest annual report (available on the Fund’s website, www.nottspf.org.uk). The Fund also publishes details of its holdings on the website on a quarterly basis.

53. This Investment Strategy Statement will be kept under review and will be revised following any material changes in policy.

APPENDIX A - Statement of Investment Beliefs

54. The Fund's investment beliefs outline key aspects of how it sets and manages its exposures to investment risk. They are as follows:

Financial market beliefs

- Return is related to risk but taking calculated risks does not guarantee returns. The actual outcome may be higher or lower than that expected.
- The Fund has a long term investment horizon and is able to invest in volatile and/or illiquid investment classes in order to generate higher returns.
- Markets are dynamic and are not always efficient, and therefore offer opportunities for investors.
- Diversification is a key technique available to institutional investors for improving risk-adjusted returns.

Investment strategy/process beliefs

- Return and risk should be considered relative to the Fund's liabilities, funding position and contribution strategy. Risk should be viewed both qualitatively and quantitatively. Particular focus should be given to the risk of loss and also to the nature and likelihood of extreme events so that the Fund is not a forced seller of assets.
- Strategic asset allocation is a key determinant of risk and return, typically more important than manager or stock selection.
- Equities are expected to generate superior long-term returns relative to Government bonds.
- Alternative asset class investments are designed to further diversify the portfolio and improve its risk-return characteristics.
- Active management can add value over time, but it is not guaranteed and can be hard to access. Where generating 'alpha' is particularly difficult, passive management is preferred.
- Operational, counterparty and reputational risk need assessment and management, in addition to investment risk.
- Managing fees and costs matter, especially in low-return environments. Fee arrangements with our fund managers – as well as the remuneration policies of investee companies – should be aligned with the Fund's long-term interests.
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Organisational beliefs

- Clear investment objectives are essential.
- Effective governance and decision-making structures that promote decisiveness, efficiency and accountability are effective and add value to the Fund.
- The Pension Fund Committee's fiduciary duty is to the members of the Pension Fund. While they are not trustees, they have trustee-like responsibilities.

<u>Responsible investment beliefs</u>

- Responsible investment is supportive of risk-adjusted returns over the long term, across all asset classes. As a long-term investor, the Fund should seek to invest in assets with sustainable business models across all asset classes.
- Responsible investment should be integrated into the investment processes of the Fund, the Pool, and underlying investment managers.
- A strategy of engagement rather than exclusion is more compatible with fiduciary duty, and is more supportive of responsible investment.
- Investee companies and asset managers with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events.
- There is risk but also opportunity in holding companies which have weak governance of financially material ESG issues. Opportunities can be captured so long as decisions are based on sufficient evidence and they are aligned with the Fund’s objectives and strategy.
- Climate change and the response of policy makers has the potential to have a serious impact on financial markets. Engagement, using partnerships of like-minded investors where feasible, can mitigate this risk.

Appendix B - Risk Management

55. The Fund has adopted a Risk Management Strategy to:
    a) Identify key risks to the achievement of the Funds objectives.
    b) Assess the risks for likelihood and impact.
    c) Identify mitigating controls.
    d) Allocate responsibility for the mitigating controls.

56. Officers are responsible for maintaining a risk register detailing the risk features in a)-d) above, for reviewing and updating it on a regular basis, and reporting the outcome of the review to the Nottinghamshire Pension Fund Committee.

57. The Risk Register is a key part of the strategy as it identifies the main risks to the operation of the Fund, prioritising the risks identified and detailing the actions required to further reduce the risks involved.

58. A key part of managing the investment risk is by ensuring that the Fund is invested through an adequate number of suitably qualified investment managers and by requiring managers to hold a diversified spread of assets. As the Pool takes over implementation of the assets, the Pension Fund's Committee's role will increasingly be to hold them to account.

59. The correlation between UK and overseas markets has increased significantly over recent time, reflecting the increasing globalisation of the market. The Fund will take into account exchange rate risks when deciding the balance between holding of UK and overseas equities. As a long term investor, the Fund does not undertake currency hedging itself. Individual managers may hedge currency risks but only with prior approval from the Fund.

60. In addition, the following advisory guidelines will apply. These guidelines will be reviewed from time to time and if changes are made these will be incorporated into a revised Investment Strategy Statement, and amendments will be published.
    - Not more than 20% of the Fund to be invested in unlisted securities.
    - No direct underwriting without prior approval.
    - No direct involvement in derivatives (including currency options) without prior approval.