

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Investment Strategy Panel Activity

Item number	5.7
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on the activity of the Investment Strategy Panel (“the Panel”) for the year to 31 March 2016.

The focus of the Panel has been on the implementation of the investment strategies of the three pension funds. Panel and the internal team have focused on restructuring and reducing the equity exposure, increasing the allocation to alternative investments, researching available bond-related investments, and making changes to Scottish Homes Pension Fund according to its funding approach. The Panel also continues to oversee the performance, asset allocation and risk of the investments.

The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013. A small amendment has been made reflecting the decision by Committee in December 2015 that the Panel should scrutinise the audit of foreign exchange transactions in future. The updated Terms of Reference are included as an appendix to this paper.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Investment Strategy Panel Activity

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That Committee notes the activities of the Investment Strategy Panel during the financial year 2015/16.

Background

- 2.1 The purpose of this report is to provide an update on the activity of the Investment Strategy Panel for the year to 31 March 2016.
- 2.2 The Investment Strategy Panel (“the Panel”) currently comprises four officers:
 - the Executive Director of Resources of the City of Edinburgh Council;
 - the Chief Executive of Lothian Pension Fund;
 - Chief Investment Officer of Lothian Pension Fund; and
 - Chief Financial Officer of Lothian Pension Fund.
- 2.3 Three investment consultants are also members of the Investment Strategy Panel (KPMG, represented by David O’Hara, and two independent advisors, Gordon Bagot and Scott Jamieson).
- 2.4 The Terms of Reference for the Panel were agreed by the Pensions Committee in June 2013. A small amendment has been made reflecting the decision by Committee in December 2015 that the Panel should scrutinise the audit of foreign exchange transactions in future. The updated Terms of Reference are included as Appendix A to this paper.

Main report

- 3.1 The Panel meets quarterly and considers all aspects of the Fund’s investments. Regular activities include reporting to and making recommendations about investment strategy to the Committee, directing and monitoring strategy implementation and risk and advising the Executive Director of Resources on investment structure and managers.
- 3.2 The Panel considers the appropriate investment management structure required to implement the Fund’s investment strategy and on the process for the appointment and monitoring of external investment managers. In addition, it is

responsible for setting objectives and restrictions for internally managed portfolios. It monitors the risk and performance of all portfolios. Panel and the internal investment team monitor all managers on a regular basis using a traffic light system to ensure that scrutiny of portfolios is robust. Performance, continuity of investment process, philosophy, people and ownership, are considered in the monitoring process. Where there are concerns over a manager, more regular and in-depth monitoring is undertaken.

3.3 The primary focus for the Panel during 2015/16 has been implementation of the investment strategies previously agreed by Committee. In addition reviews of the investment strategies for the three Funds were undertaken following the conclusion of the 2014 actuarial valuations to ensure that they remain appropriate.

3.4 Other special items have included:

- Analysis of new strategies and mandates and the impact of their inclusion on the overall funds. This year this has included the Lothian Pension Fund's emerging markets exposure and the impact of extending the internal global mandates to include emerging markets;
- Analysis and oversight of the transitions of assets;
- In-depth review of internal mandates which are subject to periodic scrutiny to assess whether they have achieved their objectives and to ensure the premise of the mandate remains sound. Panel has considered potential changes to the internal European equity portfolio, reviewed the existing US equity mandate and considered proposals from the new internal bond manager for the internal index-linked gilts;
- Cash flow projections for unlisted assets including private equity, infrastructure and timber;
- Review of members AVC investments with Standard Life and Prudential;
- Draft Statement of Investment Principles.

3.5 Panel's reviews and decisions have resulted in:

- Progress of the implementation of the pension funds' investment strategies, as detailed elsewhere on the agenda;
- Reduced number of equity mandates for Lothian Pension Fund, including higher allocation to global mandates and more assets being managed internally;
- Updated mandates for each of the investment portfolios, including objectives and controls;
- Indicative timescales for further implementation of the investment strategies.

3.6 Each year, the Panel undertakes a self-assessment to review its effectiveness. The self-assessment in June 2016 will result in some minor changes to its regular quarterly meetings to make them more efficient. A new agenda planning document has been developed – see Appendix B.

- 3.7 Over 2016/17, the Investment Strategy Panel will focus on:
- implementation of the strategy for the three Funds, including changes to the actual allocations at the asset class level and potential changes to the structure within asset classes;
 - the potential to merge Lothian Buses Pension Fund into Lothian Pension Fund;
 - scenario analysis to ensure the best possible preparedness for potentially changing investment market environments;
 - continuing to scrutinise the management of the individual portfolios;
 - reviewing currency hedging policy;
 - continuing to explore other suitable alternative investment opportunities;
 - finalising alternative funding approaches for the Scottish Homes Pension Fund.
- 3.8 Importantly, the focus of the Panel is the long term superior asset returns of the Funds rather than the short term vacillations of the investment markets by deploying each Fund's long term capital at an appropriate level of risk.

Measures of success

- 4.1 The investment performance of the pension funds is crucial to the achievement of the required investment return which impacts on the funding level and employers' contributions. The objectives for the investments are:
- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
 - Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Financial impact

- 5.1 This report details the investment activities of the Investment Strategy Panel. The investment performance of the three Funds has a significant impact on the funding levels and potentially on the contributions required from employers.

Risk, policy, compliance and governance impact

- 6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates. The Funds' investment strategies are aimed at reducing the risk without sacrificing returns.
- 6.2 There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Executive Director of Resources, who takes advice from the Investment Strategy Panel. The Investment Strategy Panel is an important element of the governance of the

pension fund investments. In addition, active engagement with the companies in which the Fund invests should reduce risk Fund and enhance the sustainability of investment performance.

Equalities impact

7.1 There are no equalities implications as a result of this report.

Sustainability impact

8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

None

Hugh Dunn

Acting Executive Director of Resources

Contact: Bruce Miller, Chief Investment Officer

E-mail: bruce.miller@edinburgh.gov.uk | Tel: 0131 469 3866

Links

Coalition pledges

Council outcomes CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

Single Outcome Agreement

Appendices Appendix 1 – Updated Terms of Reference for the Investment Strategy Panel
Appendix 2 – Agenda Planning for Investment Strategy Panel

Investment Strategy Panel – Terms of Reference

1. Establishment

The Executive Director of Resources has established the Investment Strategy Panel (“the Panel”) to advise the Pensions Committee (“Committee”) of the City of Edinburgh Council (“Council”) in the exercise of investment functions in relation to the pension funds administered by the Council.

2. Membership

Membership of the Panel will comprise:

- The Executive Director of Resources, who will chair the Panel. In his absence, he will appoint an alternative chair;
- The Chief Executive Officer, the Chief Investment Officer and the Chief Financial Officer of Lothian Pension Fund;
- A minimum of 2 external investment professionals.

3. Meetings

Frequency: The Panel will meet at least four times each year, normally to coincide with monitoring the pension funds over calendar quarters.

Attendees: The Panel may invite any persons to attend all or part of any meeting but such invited persons shall not have a right to vote on any matter before the Panel. By prior agreement with the Executive Director of Resources, the Convener of the Committee can attend any meeting of the Panel, although it is anticipated that attendance by the Convener will be on an infrequent basis.

Quorum: A minimum of three members is required to be present including one external investment professional.

Decisions: The Panel reaches decisions by majority vote. In the event of equal votes the Chair shall have a casting vote.

Papers: Papers are distributed to members at least one week in advance of any meeting (unless a shorter period is agreed by the Chair).

Minutes: Draft minutes are forwarded to members for agreement within ten working days and thereafter circulated to the Convener of the Pensions Committee.

4. Responsibilities

The Panel is responsible for ensuring that the pension funds are properly and effectively managed and for advising Committee on all matters relating to the investments of the pension funds.

It is responsible for:

Statement of Investment Principles

- Reviewing, and monitoring compliance with, the Statement of Investment Principles and recommending amendments to Committee.

Investment Strategy

- Recommending to the Committee the funds' investment strategies and objectives;
- Monitoring the appropriateness of the strategies on an ongoing basis;
- Identifying possible new asset classes within Alternative investments and agreeing their appropriateness for the funds;
- Determining that the level of investment-related risk taken by the funds is consistent with the investment strategy;
- Determining the appropriate timing of any changes to the investment strategies, within the parameters set by Committee;
- Monitoring adherence to the investment strategies and asset allocation ranges;
- Monitoring the performance of the funds;
- Monitoring cashflow and agreeing the approach to the allocation of cash;
- In the event of extreme investment market fluctuations, the Executive Director of Resources with the advice of the Panel may undertake investment activity outside the agreed investment strategies and asset allocation ranges subject to consultation with the Convener of the Committee and reporting of such activity to the next meeting of the Committee.
- Reviewing the audit of foreign exchange transaction costs.

Investment Structure & Managers

- Advising the Executive Director of Resources on the appropriate investment management structure required to implement the funds' investment strategies;
- Advising the Executive Director of Resources on the process for the appointment and monitoring of external investment managers;
- Setting objectives and restrictions for internally managed portfolios and monitor appropriateness;
- Monitoring the risk and performance of the funds and each portfolio and ensuring action is taken to address performance issues.

Reporting

The Panel will review its effectiveness annually.

The Director will provide a report summarising the Panel's work and the outcome of its assessment of its effectiveness annually to Committee, or more frequently as required by Committee.

5. Requirements from External Investment Professionals appointed to the Investment Strategy Panel

Provide challenge and direction to the Executive Director of Resources and the internal investment team, including:

- Providing input to the advice to the Pensions Committee on investment strategy;
- Advising the Executive Director of Resources and the internal investment team on the implementation of investment strategy;
- Scrutinising the investments of the pension funds, in particular those managed internally;
- Suggesting new investment opportunities which may be suitable for the pension funds;
- Attending meetings of the Investment Strategy Panel, usually quarterly;
- Other ad-hoc advice and services, such as training.

Frequency			Month	
Annually	Fund Strategy Focus			
	Lothian Pension Fund		March	
	Lothian Buses Pension Fund		September	
	Scottish Homes Pension Fund		December	
	Asset Class Focus – Annual Reviews			
	Index-Linked (gilts & gold)		March	
	Equities (listed & unlisted)		June	
	Real Assets (property, infra & timber)		September	
	Currency Exposures/Hedging		September	
	Fixed Income		December	
	Statement of Investment Principles Investment Strategy Panel – Terms of Reference Investment Strategy Panel – Effectiveness Investment Mandates – Annual Update			June June June June
	Audit of Foreign Exchange Transaction Costs			September
	Stewardship Investment Cost Benchmarking Investment Controls & Compliance (inc. custodian) AVC Monitoring	Committee Report Committee Report Committee Report		December December December December

Frequency				Month
Quarterly	Investment Portfolio Monitoring (traffic lights) Asset/Liability Context – Investment Markets (inc Adviser Ideas/Recommendations) Investment Strategy Implementation/Funding Updates			March, June, September and December
3 Times per year	Review of Governance of Internal Portfolios by ISP member			June, Sept, Dec
Every 3 Years (minimum)	Investment Strategy Reviews Actuarial Valuation (LPF/LPBF/SHPF) Funding Strategy Statement	Committee Report Committee Report	Typically December or March	
	Internal Mandate Reviews	Most recent review:	Review due:	
	UK All Cap	June 2015	June 2018	March, June,
	UK Mid Cap	June 2015	June 2018	September and
	Europe ex-UK	June 2016	June 2019	December
	US	March 2016	March 2019	
	GLOVE	June 2015	June 2018	
	GHDY	March 2015	March 2018	
	GLOVAL	September 2014	September 2017	
	Index-linked Gilts	December 2015	December 2018	
	Fixed Income Assets	N/A	September 2016	
As required	Development Work Transitions			