

# Pensions Committee

2.00pm, Wednesday, 27 June 2018

## Investment Strategy Panel Activity

Item number	5.3
Report number	
Executive/routine	
Wards	All
Council Commitments	<a href="#">Delivering a Council that works for all</a>

### Executive Summary

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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 2018.

To enable efficient collaboration with the Falkirk Council Pension Fund, new Terms of Reference for the Panel were agreed by the Pensions Committee in March 2017. The new joint Investment Strategy Panel is designed to align governance for the investment of funds. It advises the Head of Finance of the City of Edinburgh Council and the Chief Finance Officer of the Falkirk Council.

The Panel has overseen the performance, asset allocation and risk of the investments of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. It has also focused on the implementation of the investment strategies of the three pension funds. Panel and the internal team have focused on reducing the equity exposure and increasing the allocation to alternative investments (primarily bond-related and infrastructure). A review of the investment and funding strategy of the Scottish Homes Pension Fund was also undertaken during the year.

## Investment Strategy Panel Activity

### 1. Recommendations

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Committee is requested to:

- 1.1 Note the activities of the Investment Strategy Panel during the financial year 2017/18.

### 2. Background

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- 2.1 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 2018.  

To enable efficient collaboration with the Falkirk Council Pension Fund, new Terms of Reference for the Panel were agreed by the Pensions Committee in March 2017. The new joint Investment Strategy Panel is designed to align governance for the investment of funds.
- 2.2 Lothian’s existing independent advisers, Scott Jamieson and Gordon Bagot, are members of the Panel. A further adviser will be jointly procured as a member of the Panel. Future procurement of advisers will be mutually agreed by the participating Funds ensuring that the contract end dates are staggered as previously discussed by the Committee and Board.
- 2.3 Over the year to 31 March 2018, the Panel comprised:
  - the Chief Executive of Lothian Pension Fund;
  - Chief Investment Officer of Lothian Pension Fund;
  - Independent advisers, currently Gordon Bagot and Scott Jamieson.
- 2.4 It advises the Head of Finance of the City of Edinburgh Council in the implementation of the investment strategies of the three pension funds agreed by the Pensions Committees. The Chief Financial Officer of Lothian Pension Fund also attends meetings of the Panel.
- 2.5 The joint Investment Strategy Panel also advises the Chief Finance Officer of the Falkirk Council on the implementation of strategy for the Falkirk Council Pension Fund.

### 3. Main report

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- 3.1 The Panel meets quarterly and considers all aspects of the investments of pension funds. Regular activities include reporting to and making recommendations about investment strategy to the Committee, directing and monitoring strategy implementation and risk and advising the Head of Finance on the types of investment manager to utilise. The Panel ensures that important issues are reviewed on a regular basis. Its agenda planning document is attached as Appendix 1.
- 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 2017/18 has been implementation of the investment strategies for Lothian Pension Fund and Lothian Buses Pension Fund previously agreed by Committee. For Scottish Homes Pension Fund, the Panel explored funding options, specifically less restrictive investment strategies (which include assets other than index-linked gilts) for consideration by the Scottish Government. The progress on implementation of investment strategies is reported elsewhere on the agenda.
- 3.4 Other special items have included:
- Annual Asset Class Focus reviews for Combined Equities, Property, Other Real Assets, Private Equity, Currency Exposures & Hedging and Debt Assets;
  - Review of governance of internally managed portfolios as well as review of internal mandates;
  - Review of equity portfolio objectives;
  - Consideration of carbon footprinting;
  - A review and comparison of the three internal global portfolios;
  - Audit of Foreign Exchange Transaction Costs;
  - Review of members' AVC investments with Standard Life and Prudential;
  - Review of Effectiveness of the Panel; and
  - Review of Stewardship and Engagement activities.

3.5 For the three pension funds, the reviews have resulted in:

- Continued progress of the implementation of the investment strategies:
  - the final stage of the 2012-2017 strategy for Lothian Pension Fund was implemented resulting in a strategy allocation of equities 65%, index-linked gilts 7% and alternatives 28%;
  - The 2016-21 strategy for Lothian Buses Pension Fund has evolved in line with the plan;
  - Scottish Homes Pension Fund achieved full funding, which led to the equity and property portfolios being sold over the year and reinvested in index-linked gilts to minimise funding level volatility as required in Funding Agreement with Scottish Government.
- Consideration of potential strategies for Lothian's employers to reflect different requirements/risk appetites;
- Agreement to review the options for management of property assets;
- Agreement to sell gold investment - completed in September 2017;
- Consideration of the carbon footprint data to inform approach to ESG integration and impact of climate change initiatives. This is reported elsewhere on Committee's agenda;
- Additional risk and style analysis being sought to inform ongoing monitoring; and
- Updated mandates for each of the investment portfolios, including objectives and controls.

3.6 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.

## **4. Measures of success**

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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.

## **5. Financial impact**

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

## **6. Risk, policy, compliance and governance impact**

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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 In addition, active engagement with the companies in which the funds invests should reduce risk to the funds and enhance the sustainability of investment performance.
- 6.3 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 in turn delegates to the Head of Finance, who takes advice from the Panel. The Panel is an important element of the governance of the pension fund investments.

## 7. Equalities impact

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

## 8. Sustainability impact

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- 8.1 The Statement of Investment Principles 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.

## 9. Consultation and engagement

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- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the funds and they are invited to comment on the relevant matters at Committee meetings.

## 10. Background reading/external references

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- 10.1 None

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## 11. Appendices

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Appendix 1 – Agenda Planning for Investment Strategy Panel

## Investment Strategy Panel – Agenda Planning

Frequency			Month
Annually	<b>Fund Strategy Focus</b>		
	Lothian Pension Fund		March
	Falkirk Council Pension Fund		June
	Lothian Buses Pension Fund		September
	Scottish Homes Pension Fund		December
	<b>Asset Class Focus – Annual Reviews</b>		
	Equities (listed & unlisted)		June
	Real Assets (property, infra & timber)		September
	Currency Exposures/Hedging		September
	Debt Assets		December
Annually	Investment Controls & Compliance (inc. custodian)	Committee Report	March
	Statement of Investment Principles	Committee Report	June
Annually	Investment Strategy Panel – Terms of Reference		June
	Investment Strategy Panel – Effectiveness		June
	Investment Mandates – Annual Update		June
	Audit of Foreign Exchange Transaction Costs		September
Annually	Review of Governance of Internal Portfolios by external ISP members		December
	Stewardship	Committee Report	December
	Investment Cost Benchmarking	Committee Report	December
	AVC Monitoring	Committee Report	December

Frequency				Month
Quarterly	Investment Portfolio Monitoring (traffic lights)			March, June, September and December
	Asset/Liability Context – Investment Markets (inc Adviser Ideas/Recommendations)			
	Investment Strategy Implementation/Funding Updates			
Every 3 Years (minimum)	Investment Strategy Reviews Actuarial Valuation (LPF/LPBF/SHPF) Funding Strategy Statement	Committee Report Committee Report	Typically December or March	
	<b>Internal Mandate Reviews</b>	<b>Most recent review:</b>	<b>Review due:</b>	March, June, September and December
	UK All Cap	June 2015	June 2018	
	UK Mid Cap	June 2015	June 2018	
	Europe ex-UK	June 2016	June 2019	
	US	March 2016	March 2019	
	GLOVE	March 2018	March 2021	
	GHDY	March 2018	March 2021	
	SMuRV	March 2018	March 2021	
	Index-linked Gilts	December 2016	December 2019	
Fixed Income Assets	December 2016	December 2019		
As required	Development Work			
	Transitions			