

Pensions Committee

11.00am, Wednesday, 27 September 2017

Investment Strategy Panel Activity

Item number	5.6
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for 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 2017.

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 in line with its funding approach.

To enable efficient collaboration with the Falkirk 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, and it continues to oversee the performance, asset allocation and risk of the investments. The joint Panel met in July to advise the Head of Finance of the City of Edinburgh Council and the Chief Finance Officer of the Falkirk Council.

Investment Strategy Panel Activity

1. Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider; and
- 1.2 Note the activities of the Investment Strategy Panel during the financial year 2016/17.

2. 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 2017.
- 2.2 Over that period, the Investment Strategy Panel (“the Panel”) comprised four officers:
 - the Acting 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 were also members of the Investment Strategy Panel (KPMG, represented by David O’Hara, and two independent advisors, Gordon Bagot and Scott Jamieson).
- 2.4 Pensions Committee agreed new Terms of Reference for the Panel in March 2017 to enable efficient collaboration with Falkirk Pension Fund by aligning governance for the investment of funds. The Panel continues to oversee and advise on the asset allocation, performance and risk of the investments, while the assets of the Funds remain separate and investment allocation decisions are retained by each Fund.
- 2.5 Membership of the new joint Investment Strategy Panel, which advises the Nominated Officers from the respective Councils and the respective Pensions Committees, comprises:
 - The Chief Executive of Lothian Pension Fund
 - The Chief Investment Officer of Lothian Pension Fund
 - A minimum of two external investment professionals

- 2.6 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.

3. 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 Nominated Officer on investment structure and managers. For the Lothian Funds, this is the Head of Finance, under delegation from the Executive Director of Resources.
- 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, which the external independent advisers independently review each quarter. The Panel 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 2016/17 has been implementation of the investment strategies previously agreed by Committee. These are described in items 5.7, 5.8 and 5.9 of the agenda.
- 3.4 Other special items have included:
- Reviews of all the major asset classes in the Funds, including currency exposures;
 - Analysis of potential new strategies and mandates and the impact of their inclusion on the overall funds, including European and global equity portfolios;
 - Review of the potential effects of the EU referendum on the Funds followed by an extraordinary meeting to discuss the EU referendum result;
 - Review of the governance of the internally managed portfolios;
 - Review of internal mandates to assess whether the premise of the mandates remain sound;
 - Cash flow analysis and projections for unlisted assets, including private equity, infrastructure and timber;
 - Review of members' AVC investments with Standard Life and Prudential;
 - Review of the Statement of Investment Principles;

- Review of Stewardship;
- Review of Investment Strategy Terms of Reference and Effectiveness of the Investment Strategy Panel;
- Consideration of collaboration with other LGPS funds.

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;
- A change to the implementation of the Scottish Homes Pension Fund strategy – the transition of assets managed by state Street to in-house management to increase income generation and align income and capital repayments more closely with expected pension payments;
- The transition of the Europe ex-UK equity portfolio in July 2016 to a new management process investing in companies with high and sustainable return on capital;
- Tactical changes to asset allocation prior to and post the EU referendum to reduce the impact on the Funds of a potential 'exit' vote;
- Updated mandates for each of the investment portfolios, including objectives and controls;
- Improvements to existing foreign exchange procedures to ensure best execution and ensure more useful foreign exchange audits;
- A new independent review of internal portfolios by the Panel's external advisers to improve governance – the advisers will describe this to Committee and Board members at the Investment Seminar in late October);
- Enhanced communications on the Fund's stewardship for the Lothian Pension Fund website in view of an increase in lobbying efforts of special interest groups.

3.6 Each year, the Panel undertakes a self-assessment to review its effectiveness. The self-assessment in July 2017 will result in some minor changes to its regular quarterly meetings to aid integration of the Falkirk Fund's specific requirements. The Panel ensures that important issues are reviewed on a regular basis. Its agenda planning document is attached as Appendix 1.

3.7 Over 2017/18, the Investment Strategy Panel will focus on:

- implementation of the strategy for the three Lothian Funds and the Falkirk Fund, including changes to the actual allocations at the asset class level and potential changes to the structure within asset classes;
- assessing the results of the Actuarial Valuations and how they might impact on investment strategies;
- assessing implementation options for the potential merger of Lothian Buses Pension Fund into Lothian Pension Fund, if approved;
- analysing changes to the investment market environment;
- reviewing the carbon foot-printing analysis that Lothian and Falkirk are undertaking to inform risk assessment;
- continuing to scrutinise the management of the individual portfolios;

- reviewing currency hedging policy, and the results of the foreign exchange audit;
 - continuing to explore other suitable alternative investment opportunities;
 - finalising alternative funding approaches for the Scottish Homes Pension Fund, if approved.
- 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.

4. 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.

5. 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.

6. 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, and in turn to the Head of Finance, 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 Fund risk and enhance the sustainability of investment performance.

7. Equalities impact

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

8. 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.

9. Consultation and engagement

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

10. Background reading/external references

- 10.1 None.

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11. Appendices

Appendix 1 – Agenda Planning for Investment Strategy Panel



**Lothian and Falkirk Council Pension Funds
Investment Strategy Panel
September 2017
Item 3a**

Investment Strategy Panel – Agenda Planning

This document provides the Panel with an overview of the proposed agendas for future meetings of the Investment Strategy Panel. It also provides a more general overview of the current cycle of Panel papers. An agenda planning document will be provided each quarter.

The timescales for undertaking equivalent reviews for Falkirk Pension Fund, alongside those for Lothian, will be considered as the new Investment Strategy Panel arrangements evolve. There will, of course, be other matters and papers that need to be brought to the attention of the Panel on an ad hoc basis.

The proposed agendas for the next two meetings are set out below.

December 2017

Special Items

- Fund Strategy Focus – Scottish Homes Pension Fund
- Asset Class Focus – Debt Assets Annual Review
- Review of Governance of Internal Portfolios by External ISP members
- Stewardship (Committee Report)
- Investment Cost Benchmarking (Committee Report)
- Audit of Foreign Exchange Transaction Costs
- AVC Monitoring

Quarterly Items

- Investment Monitoring
- Asset/Liability Context – Investment Markets
- Investment Strategy Implementation

March 2018

Special Items

- Fund Strategy Focus – Lothian Pension Fund
- Investment Controls & Compliance (inc. custodian)
- Internal Mandate Review – GHDY
- Internal Mandate Review – SMuRV/GLOBAL (Stable Multifactor Relative Value)
- Actuarial Valuations (LPF/LBPF/SHPF) (Committee Report)
- Funding Strategy Statement (Committee Report)

Quarterly Items

- Investment Monitoring
- Asset/Liability Context – Investment Markets
- Investment Strategy Implementation

Future Investment Strategy Panel Dates

- Friday 1 December 2017, 1.00pm, Atria One Boardroom
- March 2018 (Date & Time TBC), Atria One Boardroom

Frequency			Month
Annually	Fund Strategy Focus		
	Lothian Pension Fund		March
	Falkirk Council Pension Fund		June
	Lothian Buses Pension Fund		September
	Scottish Homes Pension Fund		December
	Asset Class Focus – Annual Reviews		
	Equities (listed & unlisted)		June
	Real Assets (property, infra & timber)		September
	Currency Exposures/Hedging		September
	Debt Assets		December
	Investment Controls & Compliance (inc. custodian)	Committee Report	March
	Statement of Investment Principles	Committee Report	June
	Investment Strategy Panel – Terms of Reference		June
	Investment Strategy Panel – Effectiveness		June
Investment Mandates *– Annual Update (* 2017 to include an overall qualitative assessment of achievement versus objective)		June	
Audit of Foreign Exchange Transaction Costs		September	
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			Typically December or March
		Committee Report Committee Report		
	Internal Mandate Reviews			March, June, September and December
		Most recent review:	Review due:	
	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	June 2015	June 2018	
	GHDY	March 2015	March 2018	
GLOVAL	September 2014	March 2018		
Index-linked Gilts	December 2016	December 2019		
Fixed Income Assets	December 2016	December 2019		
As required	Development Work			
	Transitions			