

MERSEYSIDE PENSION FUND

INVESTMENT STRATEGY STATEMENT 2017

This Investment Strategy Statement has been prepared in accordance with Statutory Instrument 2016 No. 946 PUBLIC SERVICE PENSIONS, ENGLAND AND WALES

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

Statutory Provisions

Regulation 7(1) requires an administering authority to formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State.

Regulation 7 (2) stipulates that the Investment Strategy Statement required by Regulation 7(1) must include:-

- a) A requirement to invest 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 measured 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 or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
- f) The authority's policy on the exercise of rights (including voting rights) attaching to investments.

Investment of money in a wide variety of Investments

The Fund invests in a highly diversified portfolio of assets across multiple asset classes on a global basis. Moreover, the Fund seeks to invest in a broad range of uncorrelated asset classes in order to further reduce overall portfolio risk and limit the potential "downside" effects of financial market volatility.

The maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investments is set out in the Fund's strategic asset allocation in the table below.

Strategic Asset Structure

| Asset Class | Strategic Benchmark % | Detail % | Control Range |
|--------------------------|-----------------------|----------|------------------|
| Equities | | | 48.0-58.0 |
| UK Equities | 23 | | |
| Overseas Equities | 30 | | |
| US | | 8 | |
| European (ex UK) | | 8 | |
| Japan | | 4 | |
| Asia Pacific | | 4 | |
| Emerging Markets | | 6 | |
| Fixed Interest | 18 | | 13.0-23.0 |
| UK Gilts | | 4 | |
| UK Indexed Linked Gilts | | 10 | |
| Corporate Bonds | | 4 | |
| Property | 8 | | 5.0-11.0 |
| Alternatives | 21 | | 16.0-26.0 |
| Private Equity | | 5 | |
| Hedge Funds | | 4 | |
| Opportunities | | 5 | |
| Infrastructure | | 7 | |
| Cash | | | 0.0-6.0 |
| Total | 100 | | |

The Fund's portfolio asset diversification policy is reviewed triennially with its Actuarial advisor and on a quarterly basis with its Investment Consultant and Independent Advisors under the auspices of its Medium Term Asset Allocation Strategy (MTAA).

The Fund's strategic asset allocation is reviewed and authorised at least every three years by the Administering Authority's Pensions Committee.

The fund's investment strategy is underpinned by certain core philosophies pertaining to individual asset classes *inter alia*:

- The existence of an equity or volatility *risk premium*, namely that investors are rewarded over the longer term for making investments in in equities or other assets that have a return profile that is more volatile than liability matching assets

- There is a liquidity risk premium i.e. investors are rewarded over the longer term for making illiquid investments
- Active management of asset allocation can enhance returns by taking active positions against the strategic benchmark within tolerance parameters to control risk
- Active management within asset classes is possible by internal and external managers in order to outperform specific benchmark indices. There are persistent anomalies within asset pricing that can be exploited.
- Active management requires the taking of calibrated risk i.e. volatility from the specific benchmark index returns in the short and medium term.

The fund has written investment philosophies for each of the internally managed portfolios which derive from the core philosophies above. These portfolios are ; UK Equities, European Equities, Opportunities, Direct Property, Indirect Property, Private Equity, Hedge Funds, Infrastructure and Catalyst Fund.

Under the triennial review the Fund's Scheme Actuary provides a dynamic analysis of assets and liabilities within the context of the overall objectives of the Fund *inter alia* to:

- Achieve a 100% solvency level in a reasonable timeframe;
- To maintain sufficient assets to pay all benefits as they arise;
- To implement a sufficiently prudent funding plan to protect against any potential "downside" outcomes reflecting the demographic characteristics of the Fund;
- To provide a linkage to the Fund's investment strategy and economic outlook based on its actuarial assumptions.

The Fund's Investment Consultant provides professional advice on the global strategic asset allocation of portfolio investments with the greatest probability of meeting its overall objectives.

In addition to providing a review of the Fund's investment strategy, the Investment Consultant also provides ongoing monitoring and reporting of both the Fund's assets and liabilities and the resulting progression of the Fund's funding level over time.

Within the shorter term strategic time horizon, the Investment Consultant also advises on medium term tactical asset allocation adjustments in order to exploit opportunities arising from a dynamic financial market environment within the tolerance bands set within the triennial strategic asset allocation.

This is undertaken within the Fund's Medium Term Tactical Asset Allocation framework in which the Investment Consultant advises and makes recommendations on the magnitude of medium term tactical positions to be taken around the strategic benchmark in conjunction with officers of the Fund and its Independent Investment Advisors.

The suitability of particular investments and types of investments

The suitability of particular investments and types of investments to reside within the Fund's investment portfolio are analysed within the context of the overall strategic asset allocation.

Explicit investment mandates have been established for external and internal investment managers across all asset classes with clear instructions as to how these mandates are to be managed within a range of defined investment parameters and performance targets.

All investment mandates are reviewed on a quarterly basis by the Fund's Investment Management Working Party and its Independent Advisors to ensure that returns, risk and volatility are all appropriately managed and remain consistent with the overall strategy of the Fund and the individual portfolio strategies of the Fund's investment managers.

In order to determine that the Fund's policy on asset allocation is compatible with achieving its locally determined solvency target the Investment Consultant undertakes ongoing monitoring of both the Fund's assets and liabilities in order to ascertain the Fund's direction of travel towards meeting its funding and solvency targets.

A detailed report is produced by the Investment Consultant and presented to the IMWP on a quarterly basis for discussion.

The approach to risk, including the ways in which risks are to be measured and managed

The Fund has a clearly determined approach to its risk tolerance subject to the principal objective of maximising the returns from its global investment activities within reasonable risk parameters.

Accordingly, the Fund's Actuary has identified the following key risks:

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation is significantly higher than anticipated
- Longevity continues to increase at a greater rate than anticipated
- Regulatory changes
- Changes to national pension requirements and/or Inland Revenue rules

With regard to its global investment portfolio activities, the principal risks undertaken by the Fund are related to strategic asset allocation, tactical asset allocation and the active management of investment portfolios.

In order to mitigate these risks, the Fund works closely with its appointed Investment Consultant to establish a highly diversified portfolio of investments across different asset classes and geographies with the greatest probability of meeting its funding and solvency targets.

In addition to its core investments in global equities and bonds, the Fund invests in other alternative assets such as property, private equity, venture capital and infrastructure where it is possible to identify assets with lower correlations to the mainstream.

This is designed to provide the fund with a proxy insurance policy against major financial market dislocations.

Through its Medium Term Asset Allocation framework, the fund seeks to actively control risk by reducing unintended variances from benchmark by correcting positions created by market movements on a quarterly basis in accordance with the strategic advice of its Investment Consultant and discussions with its Independent Advisors.

The Fund's approach to pooling investments including the use of collective investment vehicles and shared services

The Council has signed a memorandum of understanding with the administering authorities of the Greater Manchester Pension Fund and the West Yorkshire Pension Fund to create the Northern Pool ('the Pool') in order to meet the criteria for pooling investments released by Government on 25 November 2015.

The three funds submitted their pooling proposal to Government in July 2016 and the Department for Communities and Local Government provided its confirmation in January 2017 that it is content for the funds to proceed with the formation of the Pool as set out in the July 2016 proposal. The proposal is available on MPF's website.

Based on 31 March 2015 asset values, the total value of assets, across the three participating funds, to be invested in the Pool is £35.416bn, which is in excess of the £25bn criteria set by Government. All assets other than day-to-day cash used for scheme administration purposes will be invested via the Pool once transition is complete. Day-to-day cash is assumed to be 1% of total assets for each fund.

For the immediate future after inception of the Pool, the Fund's public-market assets will continue to be held in segregated mandates owned directly by the administering authority, but managed by the Pool. A single custodian will be appointed by the Pool, which will simplify the future consolidation of mandates.

All non-listed assets will be managed by the Pool from its formation. Subject to value for money requirements being fulfilled, new investments (i.e. those entered into after the formation of the Pool) in private market assets will be made on a shared ownership basis, via either collective investment vehicles or limited partnerships.

Legacy private market assets (i.e. those entered into prior to the formation of the Pool) will be run-off on a segregated basis.

This approach will be reviewed periodically going forwards to ensure this continues to demonstrate value for money, particularly following any changes to funds' strategic asset allocations, pool management arrangements or taxation policy in the UK or internationally.

The reviews will take place no less than every 3 years.

Once established it is intended that the Pool will provide the following services to the participating authorities on an in-house basis:

- Implement the strategic asset allocations of the participating authorities
- Management of UK and Overseas equities and bonds
- Selection of private equity, infrastructure & property funds.
- Direct UK infrastructure investment via a collective investment vehicle
- Legal and accounting support
- It is intended that the Pool will externally procure the following services:
- External fund management for certain mandates
- Common custodian for Pool (plus depositaries & fund administrators where required for any pooled funds that are established for non-listed assets)
- Investment management systems
- Audit services
- Performance analytics
- Responsible Investment advisory services
- Value for money reviews of structure

A Pool Oversight Board will be established to:

- i) provide oversight of the Pool; and
- ii) act as a forum for the participating authorities to express the views of their pension committees.

The Oversight Board's primary roles are to ensure that the Pool is effectively implementing the participating authorities' strategic asset allocations and to oversee reporting to the participating authorities' pension committees.

The legal structure of the Oversight Board is expected to be a joint committee. There will be clear separation of duties between the Oversight Board and the Pool. The Oversight Board will not be undertaking any regulated activities.

The Pool's governing documentation will grant the Oversight Body and each administering authority certain powers regarding the operation of the Pool, which can be used to ensure the effective performance of the Pool.

Reporting processes of the Pool will include regular written reports on the performance of Pool investments to the Oversight Body, which will be discussed at formal meetings.

Officers of the Pool will also report to and present directly the administering authorities' pension committees and local pension boards as appropriate.

A report on the progress of asset transfers will be made to the Scheme Advisory Board annually.

How social environmental or corporate governance considerations are taken into account in the selection non-selection retention and realisation of investments

Merseyside Pension Fund pursues a policy of Responsible Investment, arising from the belief that environmental, social and corporate governance (ESG) factors will materially affect investment performance over the long term. MPF considers that a holistic approach to investing must consider ESG factors from the outset and at all stages of the decision-making process: from investment beliefs and strategy, across all asset classes and in the strategies selected. Such an approach is consistent with MPF's view of its fiduciary duty to seek optimal investment outcomes that are in the best interests of all of its scheme participants, having regard to a prevailing public service ethos and to the long-term stability of the wider financial system.

MPF believes that it can select optimal investment strategies across asset classes that integrate ESG information into quantitative and qualitative analysis, which drives the construction and adjustment of investment portfolios. This allows for the flexibility to consider diverse investment approaches and methodologies as appropriate to the objectives and set parameters of particular mandates. The Fund evaluates and monitors the RI capability of all of its investment managers, often with reference to industry standards of best practice. MPF is a signatory of the [Principles for Responsible Investment](#) and is committed to reporting on its implementation of these Principles and promoting them across the investment industry.

MPF does not exclude investments in order to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the UK Government. However, MPF considers that this does not necessarily preclude the use of ESG integration techniques, including screening, within particular mandates where the investment objective includes the optimisation of ESG-related risk and opportunity.

The values and expectations that determine this policy are imparted through MPF's governance arrangements, which incorporate representation of all Scheme members and employers alongside the Administering Authority. Responsible Investment matters are considered through-out the governance processes that set and monitor the Fund's investment strategy and are regularly reviewed by the Fund's Investment Monitoring Working Party.

MPF regards social impact investing as entirely compatible with investing responsibly and considers such opportunities on a prudent basis (or as a ['finance-first' investor](#)). Social impact or thematic investing may provide access to diverse opportunities, uncorrelated to other assets, and can deliver acceptable risk-adjusted returns. It is recognized that the positive impacts targeted will, in many cases, closely align to the wider objectives (including financial) of many of MPF's participating employers.

The exercise of rights (including voting rights) attaching to investments

MPF considers that practicing responsible ownership of its assets is fundamental to investing responsibly over the long-term; and that, in the case of equity investments, the exercise of voting rights is an intrinsic part of the value of share ownership. The practice of stewardship is closely aligned to MPF's duty to act in the best interests of all of its stakeholders. The Fund is a signatory to the UK Stewardship Code for Institutional Investors and has published a Statement of Compliance with its seven principles.

MPF's policy with regard to the voting rights attached to its equity investments is to retain control and to exercise those rights to the fullest reasonable extent. Voting activity is not delegated to investment managers, except in circumstances where the structure of a particular investment vehicle necessitates this (but where MPF is able to determine that the manager has sufficient stewardship capability and that this activity can be monitored by the Fund). In accessing any co-mingled investment vehicle with the objective of matching the performance of a stock market index, the Fund will expect the manager to implement its voting instructions over the underlying securities on a pro rata basis.

The Fund implements its voting policy in partnership with a specialist advisor (currently [PIRC Ltd](#)) who provides appropriate research and vote execution services that cover the major markets in which shares with voting rights are held. MPF votes in line with the recommendations of its advisor, having judged that the advisor's voting guidelines

promote high standards of corporate governance and responsibility and enable MPF to exert a positive influence as shareholders concerned with value and values.

A quarterly report on voting activity is made to the Investment Monitoring Working Party. A summary of voting activity forms part of the Fund's Annual Report. Detailed voting activity information, including where the voting decision has been contrary to a company's recommendation, is made publicly available through the [Fund's website](#).

Alongside its voting policy, MPF considers engagement on ESG matters to be integral to stewardship. The focus of its engagement activity (principally, but not exclusively) is the companies in which it invests across its public equity portfolio. As such, MPF carries out engagement on a collaborative basis with suitably aligned investors through several organisations (chief among them, the [Local Authority Pension Fund Forum](#), of which MPF is a founder member), to ensure that its engagement benefits from scale and clarity of voice.

MPF strongly encourages its investment managers to carry out appropriate stewardship as part of the professional practice of asset management across asset classes and to report on that activity.