

**Agenda Item No. 4 (d)**

**DERBYSHIRE COUNTY COUNCIL  
PENSIONS AND INVESTMENTS COMMITTEE**

**9 September 2020**

**Report of the Director of Finance & ICT**

**STRATEGIC ASSET ALLOCATION BENCHMARK AND INVESTMENT  
STRATEGY STATEMENT**

**1 Purpose of the Report**

To seek approval for a new Strategic Asset Allocation Benchmark for Derbyshire Pension Fund (the Fund/Pension Fund) and a revised Investment Strategy Statement.

**2 Information and Analysis**

**Strategic Asset Allocation Benchmark**

At the last formal actuarial valuation at the end of March 2019, the funding level of the Pension Fund was 97%. This was an improvement on the funding level of 87% at the formal valuation at the end of March 2016.

The funding level of the Pension Fund is the ratio of assets to liabilities at the valuation date. The funding level provides a high-level snapshot of the funding position at a particular date.

At 31 March 2019, the assets of the Fund were valued at £4,929m and the past service liabilities were estimated to be £5,092m. The investment and membership experience of the Fund from March 2016 to March 2019 had a positive impact on the funding level.

Despite the recent turbulence in markets related to the Covid-19 pandemic, investment returns have generally been positive since March 2019. The experience related to the liabilities of the Fund over that period is more difficult to estimate, in the absence of an interim funding update. However, conversations with the Fund's actuary indicate that the current funding level is likely to be in the region of 95%.

Following the receipt of the formal March 2019 actuarial valuation, the Fund's Strategic Asset Allocation Benchmark (SAAB) has been reviewed, taking into consideration the improvement in the funding level. The following changes are proposed:

| Asset Class                    | Current SAAB  | Proposed Intermediate SAAB | Proposed Final SAAB | Final Change  |
|--------------------------------|---------------|----------------------------|---------------------|---------------|
| UK Equities                    | 16.0%         | 14.0%                      | 12.0%               | (4.0%)        |
| North American Equities        | 12.0%         | 6.0%                       | -                   | (12.0%)       |
| European Equities              | 8.0%          | 4.0%                       | -                   | (8.0%)        |
| Japanese Equities              | 5.0%          | 5.0%                       | 5.0%                | -             |
| Asia Pacific Ex-Japan Equities | 4.0%          | 2.0%                       | -                   | (4.0%)        |
| Emerging Market Equities       | 5.0%          | 5.0%                       | 5.0%                | -             |
| Global Sustainable Equities    | 3.0%          | 16.0%                      | 29.0%               | 26.0%         |
| Private Equity                 | 4.0%          | 4.0%                       | 4.0%                | -             |
| <b>Growth Assets</b>           | <b>57.0%</b>  | <b>56.0%</b>               | <b>55.0%</b>        | <b>(2.0%)</b> |
| Infrastructure                 | 8.0%          | 9.0%                       | 10.0%               | 2.0%          |
| Multi-Asset Credit             | 6.0%          | 6.0%                       | 6.0%                | -             |
| Direct Property                | 5.0%          | 6.0%                       | 6.0%                | 1.0%          |
| Indirect Property              | 4.0%          | 3.0%                       | 3.0%                | (1.0%)        |
| <b>Income Assets</b>           | <b>23.0%</b>  | <b>24.0%</b>               | <b>25.0%</b>        | <b>2.0%</b>   |
| Conventional Bonds             | 6.0%          | 6.0%                       | 6.0%                | -             |
| Index-Linked Bonds             | 6.0%          | 6.0%                       | 6.0%                | -             |
| Corporate Bonds                | 6.0%          | 6.0%                       | 6.0%                | -             |
| Cash                           | 2.0%          | 2.0%                       | 2.0%                | -             |
| <b>Protection Assets</b>       | <b>20.0%</b>  | <b>20.0%</b>               | <b>20.0%</b>        | <b>-</b>      |
| <b>Total</b>                   | <b>100.0%</b> | <b>100.0%</b>              | <b>100.0%</b>       | <b>-</b>      |

The proposed final SAAB includes a modest 2% switch from Growth Assets to Income Assets reflecting the improvement in the Fund's funding position, whilst acknowledging that the Fund is open to new members and continues to accrue additional future pension liabilities.

Whilst the final SAAB continues to assume that some of the Fund's equity allocations are managed on a regional basis, these are reduced and targeted at those regions where the Fund's In-House Investment Management Team believe that they offer portfolio diversification. It is proposed that the current equity allocations in respect of North America, Europe and Asia Pacific Ex-Japan are consolidated and switched into Global Sustainable Equities.

The Fund introduced a 3% allocation to Global Sustainable Equities in October 2018. The allocation targets investment in global companies that are sustainable in financial, environmental, social and governance terms and, where appropriate, that provide solutions to sustainability challenges.

The Fund has worked with other members of the LGPS Central Pool over the last twelve to eighteen months to build its knowledge of the asset class, and made its first allocation to the asset class in April 2020 through a collaborative West Midlands Pension Fund Global Sustainable Equity Framework Agreement. The IIMT believe that the asset class is well aligned with the

Fund's Responsible Investment Framework and Climate Strategy, and offers attractive long-term risk adjusted returns.

The proposed 2% increase in Income Assets is allocated to Infrastructure, taking the asset class weighting to 10%. Infrastructure is an attractive asset class for the pension fund, offering equity like returns, predictable long-term cash flows which are often linked to inflation, and returns with a low correlation to other major asset classes.

Whilst the overall Property allocation is unchanged at 9%, it is recommended that the Direct Property allocation is increased by 1%, offset by a 1% reduction in the Indirect Property allocation. The IIMT believes that this will allow the Fund's Discretionary Direct Property Manager to actively source additional opportunities, whilst reducing the investment management fees payable by the Fund.

Given the quantum of the proposed changes between the current and final SAAB, the IIMT recommends that an intermediate SAAB is also approved to allow the IIMT to manage the transition risk towards the final SAAB. The intermediate SAAB is expected to come into effect at the beginning of Q4 2020-21, with the final SSAB expected to come into effect by 1 January 2022 at the latest.

#### **(i) Investment Strategy Statement**

The Fund's SAAB is included in the Fund's Investment Strategy Statement. LGPS Regulations require an administering authority to prepare an Investment Strategy Statement in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the 2016 Regulations). The Fund's Investment Strategy Statement was last revised in October 2018.

Under the 2016 Regulations, the Investment Strategy Statement must be reviewed, and if necessary revised, following a material change in the factors which are judged to have a bearing on the stated investment policy, and at least every three years. Given the proposed changes to the Fund's SAAB set out in this report, a revised Investment Strategy Statement has been prepared, a copy of which is set out at Appendix 1.

In addition to the changes in the SAAB, the Investment Strategy Statement has been updated for the following:

- Extending the Fund's hedging policy to include both Income Assets and Protection Assets (previously just Protection Assets) to reduce the Fund's overseas currency exposure. The Fund continues to regard the currency exposure associated with investing in overseas equities as part of the return on overseas equities; and

- Reference to the Fund's standalone Responsible Investment Framework and Climate Strategy, both of which are supplementary to the Investment Strategy Statement.

The Investment Strategy Statement must cover:

- A requirement to use a wide variety of investments;
- The authority's assessment of the suitability of particular investments and types of investment;
- The authority's approach to risk, including how it will be measured and managed;
- The authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
- 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; and
- The authority's policy on the exercise of rights (including voting rights) attached to its investments.

The Investment Strategy Statement must also set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment and the authority is required to consult such persons as it considers appropriate regarding the proposed contents of its investment strategy.

The Fund's independent investment adviser, Anthony Fletcher, has reviewed the revised Investment Strategy Statement and the proposed changes to the SAAB and a copy of the advisor's review is set out at Appendix 2.

## **(ii) Consultation**

It is intended to consult with scheme employers, the local pension board and other stakeholders on the revised Investment Strategy Statement. The results of the consultation will be reported to Committee in December 2020.

Approval is sought for the Director of Finance & ICT, in conjunction with the Chair of the Committee, to consider the results of the consultation in the meantime, and for the Director of Finance & ICT and the Chair to determine if any revisions to the proposed Investment Strategy Statement are necessary following the consultation, in able to allow the new investment strategy. to be adopted at the beginning of Q4 2020-21.

## **3 Other Considerations**

In preparing this report the relevance of the following factors has been considered: financial, legal and human rights, human resources, equality and

diversity, health, environmental, transport, property and prevention of crime and disorder.

#### **4 Background Papers**

Files held by the Investment Section.

#### **5 Officer's Recommendations**

That the Committee:

- (i) Approves the revised Investment Strategy Statement set out in this report, including the proposed changes to the Strategic Asset Allocation Benchmark, subject to the outcome of the consultation with the Fund's stakeholders.
- (ii) Delegates the consideration of the results of the consultation, and the determination of whether any revisions to the proposed Investment Strategy Statement are necessary following the consultation, to the Director of Finance & ICT in conjunction with the Chair.

**Peter Handford**

**Director of Finance & ICT**