

## **Appendix 1 - Investment Strategy Statement**

The Royal Borough of Windsor & Maidenhead (“RBWM”) acting as the administering authority for The Royal County of Berkshire Pension Fund, a constituent member of The Local Government Pension Scheme in England & Wales, is required by Section 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 to publish an Investment Strategy Statement.

This is the second such statement published by the Royal Borough and in accordance with the Regulations it will be reviewed regularly and at no more than three year intervals.

The Regulations require the administering authority to outline how it meets each of six objectives:

### **1. A requirement to invest fund money in a wide range of instruments.**

RBWM’s policy is that the pension fund (the “Fund”) should have a highly diversified investment portfolio spread across different asset classes and different asset managers using differing approaches as appropriate. This ensures that the Fund money is invested in a wide range of instruments.

RBWM’s Pension Fund Panel has established an Investment Group which meets at least quarterly to review the Fund’s performance, asset allocation and ability to meet its target return. In addition the Investment Group Committee reviews potential new investment ideas and products offered by its investment manager, Local Pensions Partnership Investments Limited (the “Investment Manager”), and opines whether such ideas are consistent with the investment strategy of the Fund and a suitable investment.

The Investment Group receives advice from suitably qualified Officers and Independent Advisers. It also makes use of information derived from the Investment Manager. It will commission specialist work from an external adviser when it believes that neither Officers nor the Independent Advisers have sufficient experience or expertise in a particular field.

To achieve sufficient diversification the Fund divides assets across four broad categories: equities, bonds, real assets and absolute return strategies. The size of each bucket will vary depending on investment conditions but each bucket will itself be diversified.

Any investment strategy will have associated risks, including primarily that of not meeting the returns required to ensure the long-term ability of the Fund to pay benefits as they fall due. To mitigate these risks the Investment Group regularly reviews both the performance and the expected returns from the portfolio to measure whether it has met and is likely to continue to meet its return objective.

In addition the Investment Group notes that there will be an increasing gap between contributions received and benefits – i.e. that the Fund will become cash-flow negative. The Pension Fund Panel does not wish the Fund to sell assets to pay benefits. Consequently, it has resolved that a secondary objective of the investment strategy of the Fund should be to ensure that there is sufficient investment income generated from the Fund's investments to meet any cash-flow shortfall. This has been formalised as a medium term objective to generate a 2% income return across the investment portfolio (i.e. investment income should be at least equivalent to 2% of the Fund's assets).

## **2. The authority's assessment of the suitability of particular investments and types of investments.**

In assessing the suitability of investments RBWM relies on the Investment Manager to take into account relevant factors including, but not limited to, prospective return, risks, concentration or diversification of risk as well as geographic and currency exposures, as well as possible interactions with other investments in the portfolio.

Performance benchmarks are set for the Fund as a whole (target return UK CPI+4.5%) as well as for individual allocations. The Fund's target return is greater than the actuarial discount rate used to value liabilities and has been set at a level sufficient to assist in meeting the funding gap whilst not taking excessive investment risk. Furthermore the Pension Fund Panel has agreed that the Fund should aim to achieve its target return with a low level of volatility in those returns. Whilst the Fund as a whole has an absolute return target, RBWM recognises that measuring the performance of individual asset classes relative to specific benchmarks may be more appropriate.

In ensuring the suitability of investments RBWM expects Local Pensions Partnership Investments to pay regard to both the potential returns and risk (including possible interactions with other investments in the portfolio). RBWM will also consider the reputational risk of being connected with or investing in any investment proposal made by the Investment Manager. RBWM expects its managers to take into account Environmental, Social and Governance (ESG) issues when making an investment.

RBWM measures the returns and the volatility of those returns on a quarterly basis and publishes the results relative to a global group of investment funds with a similar diversified approach to investment on the Fund web-site.

### **3. The authority's approach to risk, including the ways in which risks are to be measured and managed**

There are a variety of risks to be addressed when managing a pension fund with investment risk being just one of them. In 2016, in accordance with the principles of Pensions Regulator guidance, RBWM commissioned Lincoln Pensions to undertake an Integrated Risk Management ("IRM") study of the Fund. This study looked at the interaction of employer covenant risk – the ability of the employers to meet future contributions, support the investment risk (volatility of returns) and underwrite funding risk (volatility of actuarial deficit). The study concluded that:

- The future contributions estimated by the Fund's Actuary (on the GAD's funding test, i.e. aimed at removing an actuarial deficit over 20 years) are likely to be affordable across the Fund's employers over the next 10 years.
- Some of the Fund's larger employers, notably unitary authorities, do face a number of challenges in the near term which could constrain affordability of future contributions, particularly given their statutory duties to provide adequate services.

In reaching these conclusions, the Fund's assets, liabilities, and its participating employers have been subjected to a number of adverse stress scenarios to assess resilience, which serve to test and constrain affordability. Where employers find themselves under stress, they would be required to identify and utilise financial levers in order to maintain contributions at the level required. Such levers could include support from central Government or other employers, increases in council tax rates, increasing borrowings (subject to restrictions) and pledging assets to the Fund.

Looking specifically at investment risk RBWM is of the view that the diversification of the Fund investment portfolio is so broad that investment risk (volatility of returns) is low and will continue to be low. Ex ante volatility estimates require forecasts by asset class of volatility and correlation and whilst historic data can be used to estimate volatility for listed assets, it is much more difficult for unlisted (e.g. private equity, infrastructure, real estate) assets. Furthermore RBWM notes that correlations continually change and in times of financial stress all risk assets trend to a correlation with each other of 1. This "tail risk" means that most risk models either understate risk in times of stress or conservatively over-estimate volatility in normal markets.

The Fund targets a long-term return of UK CPI+4.5%; which is sufficient for it to meet its long-term liabilities. In setting the investment strategy, the Pension Fund Panel decided that this return should be achieved with a low degree of volatility – currently the Fund targets volatility below 10% per annum over the medium term.

As a patient long-term investor the Fund is prepared to ride-out short term volatility in investment markets and may, if suitable opportunities arise, adapt its investment strategy accordingly. At each review of the Investment Strategy Statement the assumptions on risk and return and their impact on asset allocation will be reviewed.

#### **4. The authority's approach to pooling investments, including the use of collective investment vehicles.**

RBWM has broad experience of investing in pooled vehicles be they collective investment vehicles or other “collectives” such as multi-partner Limited Partnerships.

When deciding whether to invest in a collective scheme or to seek a segregated account RBWM will pay close attention to:

- The relative costs between a collective investment scheme and a segregated account with a focus on the Total Cost of Ownership
- The suitability and ability of a collective investment scheme to meet the mandate requirements of RBWM.

In recognition of the government's requirement for LGPS funds to pool their investments RBWM has agreed to become an Investment Client of the Local Pensions Partnership Investments Limited. RBWM anticipates that it will become a client of the Local Pensions Partnership Investments Limited by 1 June 2018 at which time pooling of assets will commence.

#### **5. 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.**

RBWM accepts that stakeholders will have differing views on how social, environmental and corporate governance considerations should be taken into account and believes that no “one size fits all” policy can possibly be implemented across such a diverse portfolio such as that of the Fund. Nevertheless RBWM seeks to protect its reputation as an institutional investor and ensures that the Investment Manager takes into account these issues when selecting investments for purchase, retention or sale. RBWM will not place social, environmental or corporate governance restrictions on the Investment Manager but relies on it to adhere to best practices in the jurisdictions in which it is based, operates and invests.

Furthermore RBWM has implemented three investment themes under “ESG” principles: investment in the food chain, housing and infrastructure. Specifically RBWM has made private equity investments in a “food and water” segregated account within its private equity portfolio, two farmland funds in its property portfolio, a number of infrastructure fund investments both globally and in the UK (in particular it was the seed investor in the Gresham House British Strategic Investment Fund focussed on small scale Infrastructure and Housing projects) as well as investments to support house builders via the purchase of residual shared equity loan books and a fund specialising in acquiring brownfield land for residential developments.

**6. The authority’s policy on the exercising of the rights (including voting rights) attaching to investments.**

RBWM expects the Investment Manager to exercise all rights attaching to investments including voting in accordance with recognised responsible investment guidelines. RBWM expects the Investment Manager to comply with the principles of the UK Stewardship Code.

**RBWM confirms that the Berkshire Pension Fund has no investments in entities that are connected with the authority but if in future it does these will be limited to no more than 5% of the Fund’s assets.**

Table one sets out the asset class limits as agreed by the Berkshire Pension Fund Panel 21 May 2018.

**Table one: Asset class limits**

<b>Relevant LPP Pool</b>	<b>Range</b>
Credit	5-15%
Fixed Income	0-5%
Global Equities	20-35%
EM Equity	7.5-15%
Private Equity	10-15%
Total Return	0-10%
Infrastructure	10-15%
Property	10-20%
Cash	0-5%