Draft Dyfed Pension Fund Investment Strategy Statement

1. Introduction

This is the Investment Strategy Statement (the "Statement") of Dyfed Pension Fund (the "Fund") as required by regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the "Regulations").

The regulations require administering authorities to formulate and to publish a statement of its investment strategy, in accordance with guidance issued from time to time by the Secretary of State.

The ISS is an important governance tool for the Fund. The document sets out the current investment strategy of the Fund, provides transparency in relation to how the Fund's investments are managed, acts as a high level risk register, and has been designed to be informative for all stakeholders. This document replaces the Fund's Statement of Investment Principles.

In preparing this Statement, the Fund has consulted with such persons as it considers appropriate and the document will be updated based on any factors that the Fund considers material to its liabilities, finances or attitude to risk. This statement will be reviewed at least triennially or more frequently if appropriate

2. Investment Objectives and Beliefs

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death before or after retirement for their dependants, in accordance with LGPS Regulations.

The Funding Strategy and Investment Strategy are intrinsically linked and together aim to deliver stable contribution rates for employers and a reduced reliance on employer contributions over time.

The investment objective is therefore to maximise returns subject to an acceptable level of risk whilst increasing certainty of cost for employers, and minimising the long term cost of the scheme. Having a thorough understanding of the risks facing the Fund is crucial and these are covered later in this statement.

The Fund's investment beliefs which help to inform the investment strategy are as follows:

- Funding, investment strategy and contribution rates are linked
- The strategic asset allocation is the key factor in determining the risk and return profile of the Fund's investments
- Investing over the long term provides opportunities to improve returns
- Diversification across asset classes can help to mitigate against adverse market conditions and assist the Fund to produce a smoother return profile due to returns coming from a range of different sources.
- Managing risk is a multi-dimensional and complex task but the overriding principle is to avoid taking more risk than is necessary to achieve the Fund's objectives
- Environmental, Social and Governance are important factors for the sustainability of investment returns over the long term

- Value for money from investments is important, not just absolute costs. Asset pooling will help reduce costs whilst providing more choice of investments and will therefore be additive to Fund returns.
- Active management can add value to returns over the long term.

3. Investment Strategy

Asset Classes

Translating the Fund's investment and funding objectives into a single suitable investment strategy is challenging. The key objectives often conflict. For example, minimising the long term cost of the scheme is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down fairly frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

Additionally, the employers in the Fund have different underlying characteristics and long term funding objectives.

It is the Pension Panel's policy to regularly monitor, in consultation with the actuary, the likely position regarding the solvency ratio in order that the risk of deterioration of the solvency ratio below 100% is minimised. The Pension Panel may consider amending the Investment Strategy should they be advised at some future stage that this would be the only acceptable route to avoid under funding.

The Pension Panel, following an asset liability study, has set a benchmark mix of asset types and ranges within which the investment managers may operate with discretion. This is shown in Appendix A. The Panel believes that this mix of assets will fulfil the assumptions within the valuation undertaken in March 2016, as well as taking account of the liability profile of the Fund. This mix will also help to control the risks outlined below.

A review of the strategic asset allocation is undertaken every three years following the actuarial valuation that provides the assurance that the investment strategy is aligned to the long term funding plan. This review utilises both qualitative and quantitative analysis, and covers;

- The required level of return that will mean the Fund can meet its future benefit obligations as they fall due
- The level of risk that the Fund can tolerate in absolute terms, and in relation to its funding level
- An analysis of the order of magnitude of the various risks facing the Fund is established in order that a priority order for mitigation can be determined
- The desire for diversification across asset class, region, sector, and type of security.

Managers

The Pension Panel has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Pension Panel, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate, they are consistent with the overall asset allocation for the Fund. The managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles. The manager of the passive funds in which the Fund invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices.

4. Risk measurement and management

The Fund assesses risks both qualitatively and quantitatively, with the starting point being the investment strategy review which is undertaken every three years. The Fund's approach to risk is informed by the Pension Fund Panel, its professional advisors and officers of the Fund.

The key risks that the Fund is exposed to can be grouped under the following headings asset, funding, operational and governance. These risks are identified, measured, monitored and managed on an active basis with the responsibility for oversight from the Treasury & Pension Investments Manager.

These risks are summarised as follows:

Asset Risks

- Concentration – The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity – The risk that the Fund cannot meet its liabilities because it has insufficient liquid assets.
- Manager underperformance – The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

To manage asset risks the Panel provides a practical constraint on fund investments deviating greatly from the intended approach by setting itself diversification guidelines and by investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within the Panel's expected parameters. By investing across a range of assets, including quoted equities and bonds, the Panel has recognised the need for some access to liquidity in the short term. In appointing several investment managers, the Panel has considered the risk of underperformance by any single investment manager.

Funding Risks

- Financial mismatch - The risk that Fund assets fail to grow in line with the developing cost of meeting Fund liabilities and the risk that unexpected inflation increases the pension and benefit payments and the Fund assets do not grow fast enough to meet the increased cost.
- Changing demographics – The risk that longevity improves and other demographic factors change increasing the cost of Fund benefits.
- Systemic risk – The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial "contagion", resulting in an increase in the cost of meeting Fund liabilities.

The Panel measures and manages financial mismatch in two ways. It has set a strategic asset allocation benchmark for the Fund and assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. It also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The asset allocation is rebalanced on a regular basis to ensure that it does not stray outside the ranges.

The Panel keeps under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.

The Panel seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise.

Operational risk

- Transition risk – The risk of incurring unexpected costs in relation to the transition of assets among managers. To date, no significant transitions have taken place within the Fund but if they were undertaken in future the Panel would take professional advice and consider the appointment of specialist transition managers.
- Custody risk – The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default – The possibility of default of a counterparty in meeting its obligations.

The Panel monitors and manages risks in these areas through a process of regular scrutiny of its providers and audit of the operations they conduct for the Fund.

Governance Risk

Good governance is an essential part of the Fund's investment strategy and the Fund therefore identifies **poor governance** as a potential risk that can have a detrimental effect on the funding level and the deficit. The Fund ensures that its decision making process is robust and transparent and this is documented in the Governance Compliance Statement which is published on the Fund's website.

Environmental, Social and Governance risks – The Fund's investment strategy contains its own approach on Responsible Investment. Non-compliance would expose the Fund to financial and reputational risk. The Fund believes that effective management of financially material Responsible Investment risks should support the Fund's requirement to protect returns over the long term. The Fund will seek to further integrate Responsible Investment factors into the investment process across all relevant asset classes.

5. Approach to asset pooling

The Fund is entering the All Wales pool ("the Pool) with the understanding that the pooled investments will benefit from lower investment costs, greater investment capability and access to a more diverse range of asset classes. The implementation of the Fund's investment strategy by an FCA regulated provider will lead to improved governance, transparency and reporting giving the Pension Fund assurance that its investment strategy is being implemented effectively. Following a meeting with DCLG in late 2016, the proposed Pool has formally been given permission to implement its proposals.

The key criteria for assessment of Pool solutions will be as follows:

- That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund
- That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

At the time of preparing this statement the Fund has already jointly procured a single passive equity manager for the Wales funds as set out below. These funds currently sit outside of the Pool however the monitoring arrangements will still be carried out collectively on behalf of the Pool.

Asset class	Manager	% of Fund assets	Benchmark and performance objective
Passive Equity	BlackRock	25-30	FTSE All-Share and FTSE All-World Indices Benchmark Return

The Fund intends to invest the majority of its remaining assets into the Pool but will maintain some cash balances at the fund. Investment strategy will be retained by the Fund with advice from the fund manager/operator and any other relevant professional advisors.

Structure and governance arrangements of the Pool

The Pool will appoint a third party operator authorised by the FCA to provide a series of investment sub-funds in which the assets of the participating funds will be invested.

A Joint Governance Committee (JGC) will be formally established to oversee the operator. The Committee will comprise elected members – one from each of the eight participating funds. It is anticipated that this is likely to be the Chairs of the respective Pensions Committees though administering authorities may choose to nominate alternative members if appropriate. This arrangement will provide accountability for the operator back to individual administering authorities.
It will operate on the basis of 'One Fund, One Vote', though the intention is that any decisions are reached by consensus wherever possible.

The JGC will be in regular discussions with the operator as to the specific sub-funds which should be set up within the Pool, both at the outset and on an ongoing basis.

Officers from each administering authority will attend JGC meetings (in a non-voting capacity). The officers will advise the JGC on the establishment and monitoring of the various sub-funds as well as liaise directly with the operator on any day-to-day investment matters. It is anticipated that the fund representatives on the JGC will report back to their respective individual funds' Pensions committees who will be responsible for satisfying themselves as to the effectiveness of the pooling arrangements overall and the operation of the JGC.

The local Pensions Board will also seek reassurance on aspects of the management of the Fund's investments and external scrutiny and formal due diligence of the operator and depositary will also be carried out by the FCA in their role as regulator.

The operator will be responsible for selecting and contracting with investment managers for each of the sub-funds as well as appointing other service providers such as depositary asset servicer as necessary. We anticipate at this stage that listed bonds and equities are likely to be invested through a UK based Authorised Contractual Scheme (ACS) in order to benefit from the tax transparent nature of the vehicle, though we will discuss this issue with the appointed operator. It may be that alternative vehicles are more appropriate for some other asset classes. As well as considering the options with the operator, we will also take external advice on the final proposed approach from a tax efficiency and legal compliance basis.

Under the proposed structure, the depository will hold legal title to the assets of the Pool. The operator will be responsible for managing and operating the Pool, including entering into the legal contracts with the investment managers.
The appointed operator will provide and operate a range of investment vehicles to allow collective investment by the participating funds. The operator will be responsible for selecting and contracting with investment managers for the management of the underlying assets. They will also be responsible for administration in relation to the vehicles in terms of unit pricing, valuation, handling cash flows in and out of the various sub-funds, trade processing and reporting on performance.
They will be responsible for due diligence from an audit, legal and tax perspective for the respective sub-funds and also for electing a depositary to the Pool.
The Pool will also procure independent external legal and tax advice as necessary to support them in their relationship with the operator.

6. Responsible Investment and the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments

The Dyfed Pension Fund is a long term investor aiming to deliver a sustainable pension fund for all stakeholders.
Carmarthenshire County Council as the administering authority of the Fund has a fiduciary duty to act in the best, long-term, interests of the Fund's employers and scheme members.

Responsible Investment is a fundamental part of the Fund's overarching investment strategy as set out in this Investment Strategy Statement. That is, to maximise returns subject to an acceptable level of risk whilst increasing certainty of cost for employers, and minimising the long term cost of the scheme. The Fund believes that consideration of Environmental, Social and Corporate Governance ("ESG") factors are fundamental to this, particularly where they are likely to impact on the overarching investment objective.

The Fund's approach aims to ensure that consideration of ESG factors is embedded in the investment process, utilising the various tools available to manage ESG risks and to harness opportunities presented by ESG factors.
The Fund's core principles of responsible investment are:

1. We will apply **long-term thinking** to deliver **long-term sustainable returns**.
2. We will seek **sustainable returns** from **well-governed assets**.
3. We will use an **evidence-based** long term investment appraisal to inform **decision-making** in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.

To date, the Fund's approach to Social investments has largely been to delegate this to their underlying investment managers as part of their overall ESG duties. The Fund's managers report on this matter as part of the Fund's annual ESG review.

At the present time the Pension Panel does not take into account non-financial factors when selecting, retaining, or realising its investments. They understand the Fund is not able to 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 Government.

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

Voting rights

The Pensions Panel has delegated the exercise of voting rights to the investment manager(s) on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the Fund's managers have produced written guidelines of their process and practice in this regard. The managers are strongly encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f).

Stewardship

The Pensions Panel has agreed in principle that the Fund becomes a signatory to the Stewardship Code as published by the Financial Reporting Council. They also expect both the Pool and any directly appointed fund managers to also comply with the Stewardship Code.

The Fund believes in collective engagement and is a member of the Local Authority Pension Fund Forum (LAPFF), through which it collectively exercises a voice across a range of corporate governance issues.

8. Myners Principles

Although not specifically referenced in the Regulations, the Fund continues to assess its own compliance with the Myners Principles of Good Investment Governance. A statement that sets out an assessment of compliance is presented at Appendix B.

9. Advice taken

In creating this statement, the Fund has taken advice from its Officers, its Independent Investment Advisor and its Actuary, Mercer.

Appendix A

	Benchmark (%)	Range (%)
UK Equities	25.0	23.5 – 26.5
Overseas Equities	25.0	23.5 – 26.5
Global Equities	19.0	10.0 – 30.0
Pan European Property	10.0	5.0 – 15.0
Bonds	20.0	18.5 – 21.5
Cash	1.0	0.0 – 10.0
TOTAL	**100.0**	

Overseas Equities	Benchmark (%)	Range (%)
North America	10.00	5.00 - 15.00
Japan	3.50	0.00 - 8.50
Developed Pacific (excl. Japan)	3.25	0.00 - 8.25
Emerging Markets	8.25	3.25 - 13.25
TOTAL	**25.00**	

Bonds	Benchmark (%)	Range (%)
Index Linked Gilts	10.0	5.0 - 15.0
UK Corporate Bonds	10.0	5.0 - 15.0
Overseas Bonds	0.0	0.0 – 7.0
TOTAL	**20.0**	

Additional Restriction

Total Overseas Exposure	**43.0 – 53.0%**

Appendix B

Myners 6 Principles - Compliance Checklist

1.	**Effective Decision-Making**	
	Define who takes investment decisions	Included in SIP
	Consider whether members have sufficient skills	Training - LGC members seminar, LAPFF and NAPF conferences, investment manager training days, Employer Organisation training days. Training plan in place.
	Determine whether appropriate training is being provided	Training - LGC members seminar, LAPFF and NAPF conferences, investment manager training days, Employer Organisation training days. Training plan in place.
	Assess whether in-house staffing support is sufficient	Suitably qualified and trained staff. Training plan in place.
	Establish an investment committee with suitable terms of reference	Pension Panel established with terms of reference agreed
	Draw up a business plan	A business plan has been published. An Actuarial Valuation Report, Investment Strategy Review, Funding Strategy Statement and Statement of Investment Principles are updated and produced every three years.
	Priority is given to strategic asset allocation decisions	Asset / liability study undertaken to determine asset allocation after full discussions.
	All asset classes permitted within the regulations have been considered	Property has been considered and managers appointed. Other alternative asset classes will be considered in the future.
	Asset allocation is compatible with liabilities and diversification requirement	Asset / liability study undertaken to determine asset allocation after full discussions.
	Separate contracts in place for actuarial services and investment advice	Separate contracts currently in place
	Terms of reference specified	Clear specifications issued
	Specify role of S151 officer in relation to advisers	Section 151 officer role clear in constitution
	Tender procedures followed without cost constraint factor	Tendering taken place this year
	Overall Principle 1	**Fully compliant**

2.	**Clear Objectives**	
	Set overall investment objective specific only to the fund's liabilities	Customised benchmark following asset - liability study.
	Determine parameters for employer contributions	Clear objectives outlined in SIP
	Specify attitude to risk and limits	Clearly outlined in SIP
	Identify performance expectations and timing of evaluation	Clearly outlined in SIP
	Peer group benchmark in use for comparison purposes only	In Place
	Written mandate included in management contract containing elements specified	Contract has been updated, SIP is clear on these issues
	Constraints on the types of investment are in line with regulations	In Place
	Reasons stated if soft commissions permitted	None used
	Overall Principle 2	**Fully compliant**
3.	**Risk & Liabilities**	
	In setting and reviewing the investment strategy account should be taken of the form and structure of liabilities	Full asset liability study is undertaken following the triennial valuation and prior to setting and reviewing the investment strategy
	The implications for the local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk should also be taken into account	Included in asset liability study and investment strategy
	Overall Principle 3	**Fully compliant**

4.	**Performance Assessment**	
	Consider whether index benchmarks selected are appropriate	Consideration given, and performance measured against both benchmark and market indices
	Limits on divergence from index are relevant	Fully considered and in SIP
	Active or passive management considered	Fully considered and in SIP
	Targets and risk controls reflect performance expectations	Fully considered and in SIP
	Formal structure for regular monitoring in operation	Fund returns regularly reported by independent organisation
	Arrangements in place to assess procedures and decisions of members	Audit and valuation reports. Best Value regime.
	Similar arrangements established for advisers and managers	Regular monitoring/review undertaken by Panel and officers of managers and advisers.
	Overall Principle 4	**Fully compliant**
5.	**Responsible Ownership**	
	Incorporate US Principles on activism into mandates	Custodian reports on corporate actions taken
	Engage external voting agencies if appropriate	Strong Corporate Governance policy in place through investment manager
	Review manager strategies	Own policy is in operation.
	Establish means to measure effectiveness	Regular reporting in place
	Overall Principle 5	**Fully compliant**

6.	**Transparency and Reporting**	
	SIP updated as specified	In Place. Included in the Annual Report
	Consultation undertaken on amendments	In Place. Consultation each year.
	Changes notified to stakeholders	In Place. Included in the Annual Report
	Publish changes to SIP and its availability	In Place. Included in the Annual Report
	Identify monitoring information to report	In Place. Included in SIP and reports given at prescribed intervals
	Inform scheme members of key monitoring data & compliance with principles	In Place. Included in SIP
	Overall Principle 6	**Fully compliant**