WEST MIDLANDS
COMBINED AUTHORITY

West Midlands Integrated Transport Authority (ITA) Pension Fund

Investment Strategy Statement 2018

March 2018

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1) Introduction

This is the Investment Strategy Statement (the 'Statement') of the West Midlands Integrated Transport Authority Pension Fund (the Fund) as required by regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the 'Regulations'). This statement is available to anyone with an interest in the Fund and the public generally.

The overall investment policy for the West Midlands Integrated Transport Authority falls into two parts.

- The strategic management of the assets which rests with the Integrated Transport Authority (the administering authority), now part of the West Midlands Combined Authority, who have delegated this responsibility to the Pensions Committee of the West Midlands Pension Fund (the Committee). The Committee has representation from all district councils within the West Midlands. The Committee determines the strategic management of the assets based upon the professional advice it receives and the investment objectives as set out in Section 2 below.
- The remaining elements of policy are part of the day-to day management of the assets which is delegated to the external managers and the Strategic Director responsible for the West Midlands Pension Fund at the City of Wolverhampton Council and described in Section 6.

The Committee will review this statement in response to any material changes to any aspects of the Fund, its liabilities, finances and its attitude to risk which they judge to have a bearing on the stated investment policy. This review will occur no less frequently than every three years to coincide with the actuarial valuation.

The responsibilities of relevant parties are set out in Appendix B.

2) Investment Objectives

The Committee has set the following objectives:

- Have resources available to meet the Fund's liabilities for pensions and other benefits provided when they fall due.
- Seek returns that are consistent and match those available in the major investment markets and are comparable with other institutional investors.
- Emphasise markets that over time are likely to give better returns having regard to the risks relative to the maturity of the Fund's liabilities.
- Acknowledge the risk of investing and have regard to best practice in managing that risk.

3) Risk

The risk tolerance of the Fund is gauged working with the Pensions committee, the Investment and Funding Strategy Panel and independent advisors through the setting of investment beliefs, funding and investment objectives which sets the strategic asset allocation, band and benchmarks. The Investment and Funding Strategy Panel, Fund investment officers and advisors monitor the risk of the Fund liabilities versus the benchmark. Risk taken against that benchmark is monitored using a risk register and risk management tools.

The Fund is exposed to Investment, operational, governance and funding risks. These risks are identified, measured, monitored and then managed.

The principal risks affecting the Committee are as follows:

a) The risk of a deterioration in the funding level of the Fund due to investment markets not performing as forecast. The diversification of the investments balances this risk against the objective of seeking the better performing markets in which there is relatively good liquidity.

b) The risk that the investment managers, in their day-to-day management of the assets, will not achieve the rate of investment return expected by the Committee. To limit their exposure to the risk of significantly underperforming, the Committee invests the Fund's investments in diversified core holdings, a mixture of equities, bonds and diversified growth funds producing a high level of probability of achieving near market rates of return at a relatively low cost. The Fund is also invested in actively managed non-government fixed interest arrangements.

c) Any investment decision carries with it risks of different types (for example, risk of underperformance, risk from mismatching, risk from underfunding etc). The Committee recognises these different types of risk and seeks to minimise them as far as possible by regular monitoring of the performance of the Fund managers, seeking advice from the actuary on the suitability of the assets with regard to the Fund's liabilities, regularly receiving advice from a range of professional advisors and ensuring that the Fund's portfolio is suitably diversified.

d) Inflation risk

The Fund mitigates inflation risk through holding a portfolio of growth and inflation-linked assets. Inflation risk is considered triennially as part of the actuarial valuation.

e) Changing demographics

The risk of changing demographics such as improvement in longevity and other demographic factors, increasing the cost of benefits.

The Committee monitors this by reviewing mortality and other demographic experience and assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.

Buy-in strategy

During 2012, the Fund arranged an insurance 'buy-in' of part of the current liabilities for pensions in payment to more effectively manage the investment, interest and longevity risks.

4) Investment Strategy

The Committee sets a long-term investment strategy (the mix of asset types) in regard to the Fund's liability structure and the investment objectives set out in section 2. This is reviewed at least every three years, after each actuarial valuation. It will not make tactical asset allocation decisions unless market movements or related issues suggest otherwise.

As a result of the buy-in impacting the liabilities of only one of the underlying employers, a separate 'non-buy-in' investment strategy has been implemented for the participating employer that was not involved in the buy-in. This strategy, together with the 'post-buy-in' strategy (for the employer that was involved in the buy-in) is outlined in Appendix A. As at 31 December 2016, the 'buy-in' policy represented 51% of the total Fund assets (53% of total NX assets).

In 2015, the assets attributable to the Fund's two employers were unitised so that they are now separately identified. There is a governance benefit from unitisation – it is the best method of providing the level of robustness required when Fund assets are formally assigned to individual employers. It also provides greater flexibility for the future, facilitating bespoke investment strategy and management arrangements for each employer segment.

5) Diversification

The Fund will be diversified across multiple asset classes with different risk return expectations and correlations to deliver the targeted return of the Fund.

The Fund will use risk attribution provided by independent advisors to assess diversification benefits.

6) Day-to-Day Management of the Assets

Investment Management Structure
The Fund invests its main assets in portfolios operated by three external investment managers, all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The investment managers are required to comply with LGPS investment regulations. The Committee is satisfied that the spread of assets by type and the investment managers' policies on investing in individual securities within each type provides adequate diversification of investments.

Suitable Investments
Subject to the LGPS regulations on allowable investments the Fund may invest in a wide range of assets and strategies including quoted equity, government and non-government bonds, currencies, money markets, commodities, traded options, financial futures and derivatives, alternative strategies (including insurance linked securities and loans), private equity and debt markets, infrastructure and property. Investment may be made in physical assets or using derivatives.

The Fund may also use external managers to carry out stocklending ensuring suitable controls/risk parameters are put in place to prevent losses. Where an asset class/strategy is not expected to help in delivering the risk-adjusted investment return required it will not be held.

When new asset classes are discovered not listed above, then approval will be sought from the Committee after receiving advice on its suitability and diversification benefits.

Expected Return on the Investments
Appendix A shows the benchmark asset allocations for the fund and its two sub-funds, the Fund is rebalanced back to target allocations periodically when it moves outside tolerance ranges or the level of cash make it prudent to do so.

Over the long term, it is expected that the investment returns will be at least in line with the assumptions underlying the triennial actuarial valuation. The individual portfolios should match or exceed the specific market benchmarks set for each portfolio over time.

Investment Restrictions
The investment management arrangements prohibit the holding of investments not defined as 'investments' in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. Operating within the investment regulations, the Fund determines investments that are acceptable and approved as such by the Committee.

Additional Assets
Assets in respect of members' additional voluntary contributions are held separately from the main Fund assets. These assets are held with Equitable Life and the Prudential Assurance Company Limited. Members have the option to invest in with-profits funds, unit-linked funds and deposit funds.

The Committee monitors from time to time the suitability and performance of these vehicles. No new business is being placed with Equitable Life.

Realisation of Investments
In general, the Fund's investment managers have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments. The Fund is mature in terms of benefit liabilities and has a strong cash outflow on a regular basis. The need to realise investments is reviewed as appropriate by the Investment and Funding Strategy Panel.

Monitoring the Performance of Fund Investments
The performance of the investment managers is independently measured. In addition, officers of the Fund meet the investment managers regularly to review their management of the portfolio together with the reasons for the background behind the investment performance. The Investment and Funding Strategy Panel meets at least quarterly to review markets and managers.

7) Pooling

The Fund is entering the LGPS Central pool with the understanding that the pooled investments will benefit from lower investment costs, greater investment capability and access to more uncorrelated asset classes. Becoming an FCA-registered investment manager will lead to improved governance, transparency and reporting giving the Fund assurance that it's investments are being carried out effectively.

The Fund intends to invest all its assets into the LGPS pool with the exception of the buy-in strategy and some cash balances that will remain with the Fund.

8) Responsible Investment

The Fund's approach to responsible Investment is set out below and further detailed in our Responsible Investment Framework. 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 (adding corporate governance, environmental and social factors to the existing financial factors) into the investment process across all relevant asset classes. The Fund will vote on all investments where possible and engage with companies when engagement will add value to the Fund. The Fund is a signatory to the Stewardship Code and the Principles of Responsible Investment.

The Fund works with like-minded investors to promote best practice in long term stewardship of investments. The Fund will not seek to exclude investments that are not barred by UK law.

Where assets are managed by external managers in pooled vehicles, the internal manager expects (in selection and monitoring) the manager to meet the same responsible investment standards as internally managed funds.

Corporate Governance
The Fund recognises its responsibility as an institutional investor to support and encourage good corporate governance practices in the companies in which it invests. The Fund considers that good corporate governance can contribute to business prosperity by encouraging accountability between boards, shareholders and other stakeholders. Good corporate governance also plays a major role in encouraging corporate responsibility to shareholders, employees and wider society.

The Fund supports good corporate governance in the companies in which it invests and the challenging of companies who do not meet the standards or reasonable expectations set by their peers.

Socially Responsible Investment
Socially responsible investment is taken as giving consideration to issues that give risk to social concerns – for example, employment practices, human rights, use of natural resources, environmental issues and external business standards. This links to, and covers, the issues around sustainability that have a rapidly growing significance for companies from a legislative, reputational and practical operational standpoint. Lack of good governance interferes with a company's ability to function effectively and is a threat to the Fund's financial interest in that company.

RI investments will be considered where any non-financial benefit is aligned with a positive financial benefit.

The Fund is also a member of the Local Authority Pension Fund Forum. This Forum exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance among the companies in which they invest.

9) Compliance With This Statement

The Fund will monitor compliance with this statement. In particular it will obtain confirmation from the investment managers that they exercised their powers of investment with a view to giving effect to the principles contained in the statement so far as is reasonably practicable. The Fund undertakes to advise the investment managers promptly and in writing of any material change to this statement.

10) Compliance With Myners

Following from the Myners' report of 2000 into Institutional Investment in the UK, the Government, after consultation, indicated it would take forward all of the report recommendations and identified ten investment principles to apply to pension schemes.

These principles cover the arrangements for effective investment management decision-making, setting and monitoring clear investment objectives, focus on asset allocation, arrangements to receive appropriate expert advice, explicit manager mandates, shareholder activism, use of appropriate investment benchmarks, measurement of performance, transparency in investment management arrangements and regular reporting.

The Myners' principles have since been updated and consolidated into six. The Fund supports the principles and complies with the principles. Full details of compliance are set out in the Fund's Myners' Compliance Statement which can be found on the Fund's website.

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Appendix A – Target Asset Allocation

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Appendix A: Target Asset Allocation

Asset class	Total Fund %	National Express % (post-buy-in)*	Preston Bus % (non-buy-in)
Growth			
Quoted equities	27.6	28.0	22.5
Diversified growth funds	37.0	38.3	22.5
Total growth	**64.6**	**66.3**	**45.0**
Income and stabilising			
Fixed income	22.3	19.7	54.4
LDI	13.0	14.0	0.0
Cash	0.1	0.0	0.6
Total income and stabilising	**35.4**	**33.7**	**55.0**

*The buy-in represented 50% of NX assets as of 31 December 2017.

The tolerance ranges for the combined fund are as follows:

60% - 70% Growth
30% - 40% Defensive

Appendix B: Roles and Responsibilities

Pensions Committee
Pensions Committee consists of 'Trustees' who sit as the decision-making body of the Fund.

The City of Wolverhampton Council each year at annual council appoints elected councillors to sit on the Pensions Committee and allows nominations from the district councils to sit as full members. These nominations are received each year and are appointed at annual council.

As a statutory public service scheme, the Fund has a different legal status compared with trust-based schemes in the private sector. Although those making decisions relating to the Fund are required, in many ways, to act as if they were trustees in terms of their duty of care, they are subject to a different legal framework and are not trustees in the strict legal sense.

Role of Pensions Committee

- To discharge the functions of the administering authority for the application of the Local Government Pension Scheme Regulations for the West Midlands ITA Pension Fund.
- To put in place and monitor the administration of contributions and payments of benefits as required by the regulations, and the proper management and investment of monies held for the purpose of paying benefits.
- To determine and review the provision of resources made available for the discharge of the function of administrating authority.

Key Duties:

Pensions Committee

- Monitor compliance with the legislation and best practice.
- Determine investment policy based on recommendation:
  - benchmark (medium-term)
  - monitor policy
- Appoint committee advisers.

Investment and Funding Strategy Panel

- Monitor investment management arrangements.
- Review strategic investment opportunities.
- Monitor implementation of investment policy.
- Monitor investment activity and performance of the Fund.
- Oversee the administration of investment management functions of the Fund

Appendix C: List of Advisers

Advisers
The Fund uses a range of advisers in addition to its own specialist officers as follows:

Hymans Robertson
Investment advice and selection of investment managers

Barnett Waddingham
Actuarial matters and investment matters relative to liabilities

HSBC
Performance measurement, unitisation.

Portfolio Evaluation
Performance and risk measurement

City of Wolverhampton Council Officers of West Midlands Pension Fund
Day-to-day oversight of investment arrangements, management of cashflows, and pension administration.

Fees paid to advisors are agreed on an individual basis for a fixed sum or scale reviewed annually or as work is commissioned.

Appendix D: Statement of Investment Beliefs

The Fund's investment beliefs outline key aspects of how it sets and manages the Fund's exposures to investment risk. They are as follows:

Financial Market Beliefs

- There exists a relationship between the level of investment risk taken and the rate of expected investment return. As taking calculated risks does not guarantee returns, investment losses or below expected returns are possible outcomes.
- Markets are dynamic and are not always efficient, and therefore offer opportunities for skilled active managers.
- In making investments in illiquid assets, a return premium should be sought.
- Diversification is a key technique available to institutional investors for improving risk-adjusted returns.
- The Fund believes that investing for the long term can add value to the fund as it allows the Fund manager to focus on long-term value and use short-term volatility to establish favourable investments.
- Where an asset class/strategy is not expected to help in delivering the risk adjusted investment return required it should not be held.

Investment Strategy/Process Beliefs

Clear investment objectives are essential. Return and risk should be considered relative to the Fund's liabilities, funding position and contribution strategy.

Risk should be viewed both qualitatively and quantitatively. Particular focus should be given to the risk of loss and also to the nature and likelihood of extreme events so that the Fund is not a forced seller of assets.

- Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection.
- Equities are expected to generate superior long-term returns relative to government bonds.
- Alternative asset class investments are designed to further diversify the portfolio and improve its risk-return characteristics.
- Active management can add value over time but it is not guaranteed and can be hard to access. Where generating 'alpha' is particularly difficult, passive management is preferred.
- Operational, counterparty, conflicts of interest and reputational risk need assessment and management, in addition to investment risk.
- Concentrated portfolios (smaller numbers of holdings or fewer external managers) allow for greater investment focus, lower investment costs and enable more focused engagement with responsible investment
- Managing fees and costs matter especially in low-return environments. Fee arrangements with our Fund managers – as well as the remuneration policies of investee companies – should be aligned with the Fund' long-term interests.

Organisational Beliefs

- Effective governance and decision-making structures that promote decisiveness, efficiency and accountability are effective and add value to the Fund.
- When outperformance of a desired benchmark is not possible, the Fund will use index funds, financial instruments or proxies (investments that share similar characteristics) to gain exposure to the asset class in the most cost-effective way.
- Investment costs are necessary to generate outperformance in asset classes where outperformance is achievable. Investment costs are a certain cost that should be fully transparent and managed by the operator in the best interests of the Fund.

Responsible Investment Beliefs

- Effective management of financially material ESG risks should support the Fund's requirement to protect returns over the long term.
- Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events.
- There are some investment opportunities arising from environmental and social challenges which can be captured so long as they are aligned with the Fund's investment objectives and strategy.
- Responsible investment should be integrated into the investment process
- The Fund will manage responsible investment factors through engagement rather than exclusions.

West Midlands Pension Fund
PO Box 3948
Wolverhampton
WV1 1XP