

Pensions Board

9 July 2020

Report title	Investment Governance	
Originating service	Pension Services	
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Recommendations for noting:

The Board is recommended to note:

1. The revised Investment Strategy Statement in place for the Fund following review in conjunction with the 2019 actuarial valuation, consultation and approval in March 2020.
2. The Fund's updated Responsible Investment Framework incorporating updated Stewardship themes for the next three years, approved in June 2020.
3. The Fund's Investment Risk and Assurance Framework approved in June 2020.
4. The update on investment governance matters including those in relation to responsible investment and investment pooling.

1.0 Purpose and Background

- 1.1 This report provides an update on investment related matters including review of the Fund's Investment Strategy, the ongoing development of LGPS Central Investment Pool and the Fund's responsible investment activities.
- 1.2 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, in force from 1 November 2016, require Administering Authorities to publish their first Investment Strategy Statement (ISS) from 1 April 2017 and keep under review.

To comply with the regulations and guidance, the ISS 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.
- 1.3 LGPS Central Ltd ("the Company") is a jointly owned investment management company established by West Midlands Pension Fund and seven Partner Funds to deliver investment pooling for the LGPS Central pool in accordance with the criteria laid down by the Secretary of State.
- 1.4 Investments products and services to Partner Funds are being developed, supported and overseen by the governance structures established within the Company and across the wider investment pool. The Shareholder Forum and Joint Committee each meet at least twice annually with the Shareholder Forum considering shareholder related matters such as the Company's strategic business plan, annual budget and annual report and accounts. The Joint Committee is focused very much on client deliverables of investment pooling, together with governance and oversight of pooling arrangements.
- 1.5 The Fund has a longstanding policy of supporting good corporate governance in the companies in which it invests. The Fund will also challenge companies who do not meet either the standards set by their peers or reasonable expectations as measured by best practice. The Fund's approach is part of its overall investment management arrangements and its active responsible investment framework. There are three main pillars to the framework: **selection** (of assets), **stewardship** (of assets), and **transparency & disclosure**.

2.0 Investment Strategy

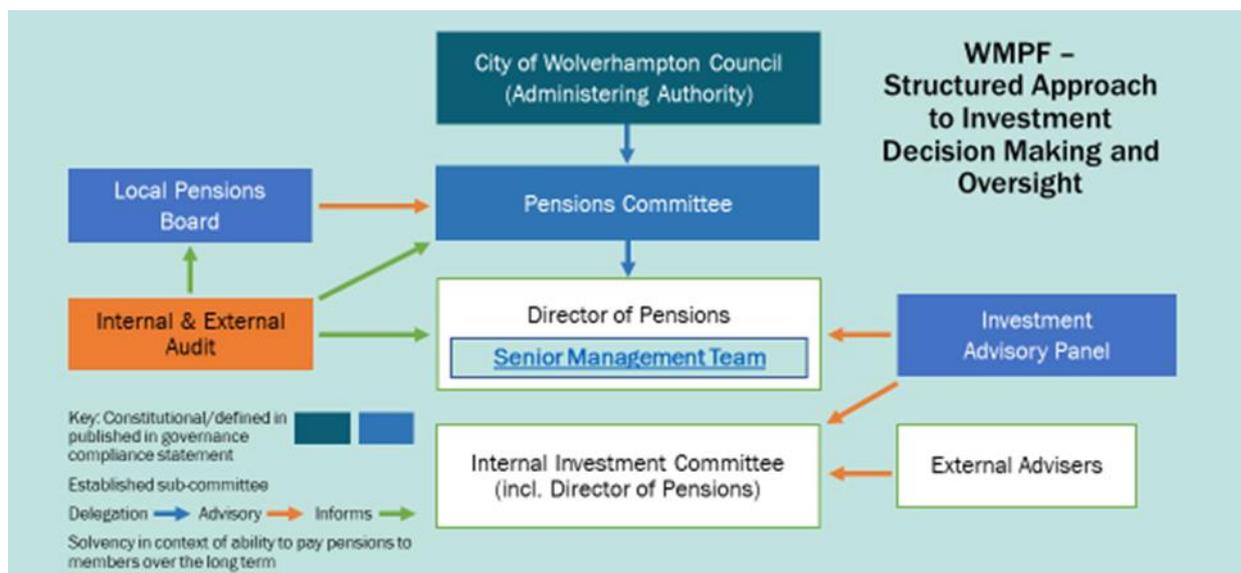
- 2.1 The Fund undertook a review of Investment Strategy in conjunction with the triennial Actuarial Valuation during 2019/2020 with a revised strategy being incorporated into the Investment Strategy Statement (ISS) approved under urgent decisions by the Pensions Committee in March 2020 and has now been published on the Fund's website. A copy of the Investment Strategy Statement is appended to this report at Appendix A.
- 2.2 The updated investment strategy also incorporated a review of the Fund's wider investment beliefs looking to refine and build on previous iterations of Fund beliefs and in setting the context for wider strategy work, these updated investment beliefs have been included at a high level within the main body of the ISS and the detailed beliefs as an appendix to the ISS. The Fund's Investment Advisory Panel (IAP) were fully engaged and consulted on the development of the new strategy. Employers and advisers were consulted on the new ISS as part of the review process.
- 2.3 Following the merger of the WMITA Pension Fund with the Main Fund, the Fund has amalgamated the investment strategies of the two new separate admission body funds (2 former employers of WMITA Pension Fund) into the main ISS.
- 2.4 When setting Investment Strategy, the Fund looks to set a medium-term strategy to cover the next one to two actuarial valuation cycles (3-6 years) reflecting on the longer-term funding requirements and the development of the future benefit cashflow and evolving liability profile of the Fund. It is recognised that conditions may well change over that time period and as a consequence the Fund will keep its ISS under review.

3.0 Investment Risk and Assurance Framework

- 3.1 The Fund's strategic asset allocation is set out in the Investment Strategy Statement as noted above. Invested assets were valued at over £16bn as at the end of May 2020 with a diverse range of investments held to deliver the Fund's investment objectives. How the Fund manages and oversees the implemented investment arrangements is a critical part of the Fund's broader governance structure.
- 3.2 The Investment Risk and Assurance Framework forms part of the Fund's Internal Controls Framework and defines the commitment of West Midlands Pension Fund to an integrated approach to investment risk and assurance. The Investment Risk and Assurance Framework is part of the broader integrated risk management for the Fund. It focuses on the implementation of strategy for assets under management and is supplementary to the Fund's Investment Strategy Statement, aligning with the Fund's investment beliefs and fiduciary duty. The Pension Committee approved the Fund's Framework at its meeting on 17 June 2020 and a copy is included within the Legal and Compliance Report to this Board meeting.

The Framework outlines the investment governance arrangements for decision making incorporating those set out in the Council's Constitution along with the structures which support the Fund with day-to-day management activity, setting out clearly the role that the Local Pension Board plays in supporting Pensions Committee in oversight of investment arrangements.

The diagram below shows the key governance arrangements:



4.0 LGPS Central Investment Pool Sub-Fund Development and Asset Transition

- 4.1 As previously reported to the Board, since launch and over the next 2-3 years, a range of internally and externally managed sub-funds are being developed for liquid (e.g. equities and bonds) and alternative more-illiquid asset classes (e.g. private equity, property, infrastructure).
- 4.2 WMPF works closely with LGPS Central Ltd and Partner Funds to agree sub-fund product development, with ultimate investment decisions formed based on whether the new sub-fund meets the strategic requirements of the Fund and considering potential cost benefits net of transition costs.
- 4.3 The Fund's Investment Advisory Panel, comprising external advisers, the Director of Pensions and Assistant Director (Investment and Finance), continue to review investment in sub-funds as they are developed taking into account the strategic fit for WMPF. The Pensions Committee are kept updated on product development and are asked to re-confirm delegations to transition assets as appropriate to these emerging sub-funds.
- 4.4 In aggregate as at the end of May, the Fund has transitioned approximately £6.4bn or around 40% of assets under management directly invested in LGPS Central Ltd sub-funds, helping demonstrate compliance with statutory guidance on LGPS Investment Pooling. In addition, the Fund also has a further £7.2bn (just over 40%) under advisory and execution arrangements.
- 4.5 Since the Board last met the Fund has invested £200m in a corporate bond sub-fund and is currently working closely with Partner Funds and LGPS Central Ltd on the launch of products for emerging market debt and multi-asset credit.

- 4.6 The product development pipeline continues to evolve and be reviewed as strategic priorities and opportunities develop and the Fund works closely with its Partner Funds and LGPS Central Ltd to ensure that suitable products become available to meet the Fund's broader strategic objectives.

5.0 LGPS Central Investment Pool Governance

- 5.1 As previously reported to the Board, the governance arrangements for the LGPS Central pool include a Shareholder Forum (as the group of "owner" representatives) and the Joint Committee (focused on investment matters and client-side). The Joint Committee has invited a trade union representative to join the Committee and is waiting for a nomination from the TUC. A representative from the West Midlands' Pension Committee is currently attending on an informal basis. The Practitioners Advisory Forum, PAF (officer group) support both groups and act as a liaison with the Company.
- 5.2 The Shareholder Forum last met in November 2019 and was due to meet in March 2020, but due to the developing Covid19 pandemic this meeting was deferred.
- 5.3 The Joint Committee met in February and received updates on the workstreams from the Practitioners Advisory Forum (including finance, investment, client and governance oversight and responsible investment), along with the risk and audit assurance framework, and delivery and performance updates. The Joint Committee also received an update from the internal audit working group which undertook an internal audit of the governance arrangements for investment pooling which were satisfactory with a number of minor recommendations which are currently being implemented. An Investment audit is currently underway but has faced some delays due to Covid19 and again the results of this audit will be presented to the Joint Committee in due course.
- 5.4 The Board were previously advised of draft guidance issued by MHCLG in January 2019, noting in particular, the emphasis on the Pool governance and oversight. It is understood that a formal consultation is due to be issued but was postponed from the autumn and we are awaiting a further update from Government as to when this updated guidance will be issued.
- 5.5 LGPS Central Limited's own governance arrangements include an Investment Committee, Executive Committee and oversight from the Non-Executives through the company board and sub committees (Remuneration and Audit and Compliance). The Company also sought and obtained permission from Shareholders to recruit for an additional non-executive director who has now been formerly appointed to the Board.

6.0 Responsible Investment

- 6.1 The Fund's strategy continues to be to engage with its investee companies and other key stakeholders through partnerships and on its own. The Fund aims to protect and increase shareholder value by engaging on a range of financially material ESG investment factors. A significant part of the Fund's engagement programme is implemented through partnerships including the Principles for Responsible Investment (PRI), the Local Authority Pension Fund Forum (LAPFF), Hermes EOS (via a contract held by LGPS Central Limited, the pool operator company), Institutional Investors Group on Climate Change (IIGCC) and the UK Pension Fund Roundtable.

- 6.2 The Fund's engagement activity is monitored and reported to the Pensions Committee on a quarterly basis. Engagement activity includes a number of direct company engagements, on a range of themes, voting activity and working in partnership with other institutional investors to consider shareholder resolutions. Activity and progress are included in published reports from LGPS Central Limited and the Local Authority Pension Fund Forum (LAPFF).
- 6.3 The stewardship themes for engagement for the Fund for the 2019/2020 financial year were: Climate Change; Single-use plastics; Technology and Disruptive Industries; Tax Transparency and fair tax payment. Whilst not a specific theme for the year, the Pensions Committee were keen that there was a focus on Human Rights and the Fund has provided more detailed reporting on this additional theme for Pensions Committee in addition to the previously agreed themes. The Pensions Committee continues to review engagement activity and developments on a quarterly basis and respond to enquiries from members, stakeholders and campaign groups, as these are received and through statements and material published on the Fund website.
- 6.4 Following a review of the Fund's Responsible Investment Framework an updated Framework along with new engagement themes to cover the period 2020-23 were approved by Pensions Committee at its meeting on 17 June. The new engagement themes for the next three years have been agreed as: Climate Change; Sustainable Food Systems; Human Rights and Responsible Financial Management. The recently approved updated Responsible Investment Framework can be found on the Fund's website and is attached as at appendix B to this report.
- 6.5 The Fund has been a signatory of the UK Stewardship Code ('the Code') since its inception in 2012. The Fund defines the concept of stewardship in the same way as the FRC: *"Stewardship aims to promote the long-term success of companies in such a way that the ultimate providers of capital also prosper. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings."*
- 6.6 The FRC has now published an updated Code which came into effect from 1 January 2020. The Code represents a new best practice standard for both asset owners and asset managers alike. The new guidelines require that Funds who want to remain or become signatories of the Code must publish a Stewardship Report, demonstrating compliance with the 12 principles of the Code by 31 March 2021. The Code will also be used in conjunction with forthcoming guidance to be issued by the Scheme Advisory Board, as a basis for reviewing and strengthening the Fund's approach to responsible investment activity. The Fund will be working in conjunction with LGSPC Ltd to update the Fund's current statement on compliance with the Code ahead of March 2021.

7.0 Financial implications

7.1 There are no direct financial implications arising as a result of this report.

8.0 Legal implications

8.1 The requirement under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 with updated Guidance on preparing and maintaining an Investment Strategy Statement (ISS) has been met with the review and publication of the ISS attached at appendix one.

8.2 The requirement to pool fund investments is a requirement of law, failure to work collaboratively and meet the Government's criteria and timetable for delivery may result in Government intervention.

8.3 MHCLG issued updated draft statutory guidance relating to investment pooling for informal consultation in January 2019. This was to update and replace the original statutory guidance issued in 2015. Both the Fund and LGPS Central Ltd have provided responses to the consultation and MHCLG and currently expected to issue a formal consultation in 2020.

9.0 Equalities implications

9.1 There are no direct equalities implications.

10.0 Environmental implications

10.1 There are no direct environmental implications.

11.0 Human resources implications

11.1 There are no direct human resources implications.

12.0 Corporate landlord implications

12.1 There are no direct corporate landlord implications.

13.0 Schedule of background papers

13.1 Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 <http://www.legislation.gov.uk/ukxi/2016/946/contents/made>

13.2 Ministry for Housing, Communities and Local Government (MHCLG) Statutory Guidance on Preparing and Maintaining an Investment Strategy Statement 2017: <http://lgpslibrary.org/assets/statgui/ew/201707ISS.pdf>

14.0 Schedule of appendices

14.1 Appendix A – WMPF Investment Strategy Statement.

14.2 Appendix B – WMPF Responsible Investment Framework.