



Worcestershire Pension Fund DRAFT Investment Strategy Statement 2020

1. Introduction

This is the Investment Strategy Statement (the ‘Statement’) of the Worcestershire Pension Fund (the Fund) as required by regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the “Regulations”). In preparing this Statement, the Pensions Committee has consulted with such persons as it considered appropriate.

Worcestershire County Council is the administering authority for the Fund under the regulations. Worcestershire County Council delegates responsibility for the administration and management of the Fund to the Pensions Committee. The Pensions Committee has oversight of the implementation of the management arrangements for the Fund's assets and comprises of Elected Members and one Employee Representative and one Employer Representative. In addition, the Fund has the statutory Local Pensions Board whose role is to assist in the good governance of the scheme by ensuring compliance with statutory and regulatory duty. Finally, the Pensions Investment Sub Committee advises the Pensions Committee on investment issues relating to the Fund. The Local Pensions Board has no decision-making powers whereas the Pensions Investment Sub Committee does.

This statement which is reflected in the Strategic Allocation in Appendix A demonstrates the importance of Asset allocation on returns over the long term.

The Statement is subject to review at least annually and from time to time on 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. In preparing this statement, the Committee has considered advice from the investment adviser.

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

The Fund's Statement of Investment Beliefs are set out in Appendix D.

Related Fund policies and statements are as follows and are publicly available on the Fund's website:

- Funding Strategy Statement (on website)
- Governance Compliance Statement (Within Annual Report on website)
- Policy Statement on Communication Strategy (Within Annual Report on website)
- Policy Statement on Governance Strategy (Within Annual Report on website)

2. Fund Objectives

The primary objectives of the Fund are to:

- (a) ensure that sufficient assets are available to meet liabilities as they fall due;
- (b) Maximise the return at an acceptable level of risk.

The level of employer contribution is assessed every three years through an actuarial valuation of the Fund. This valuation establishes the solvency position of the Fund, that is, the extent to which the assets of the Fund are sufficient to meet the Fund's pension liabilities accrued to date. The objective is that the Fund should be at least 100% funded on an ongoing basis, taking account of any additional contributions paid by employer bodies to cover any past service deficit. The full funding projection is achieved over a 15-year time frame.

In addition, the Fund has the following objectives:

- To be a leading performer in the LGPS sector
- To provide excellent customer service

Funding Strategy Statement

The Funding Strategy Statement (FSS) and Investment Strategy Statement (ISS) are intrinsically linked and together aim to deliver stable contribution rates for employers and a reduced reliance on employer contributions over time. The FSS can be viewed on the website.

All Local Government Pension Scheme (LGPS) funds must produce, consult on and publish a document called a "Funding Strategy Statement" (FSS). The purpose of the FSS is:

- a) To establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- b) to support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
- c) to take a prudent longer-term view of funding those liabilities.

However, there will be conflicting objectives which need to be balanced and reconciled. For example, for most employer's objective a) implies low contribution rates, because they would see pension liabilities being "best met" by gaining as much help as possible from the investment strategy over the long term, which would lead you towards an equity-biased investment strategy. By contrast, objectives b) and c) imply stability and prudence of employer contribution rates, which would lead you towards a bond biased investment strategy.

Therefore, the best that can be achieved is a sensible balance between these different objectives

3. Risk

The risk tolerance of the Fund is determined through working with the Pensions committee, the investment managers, officers and independent advisers by the setting of investment beliefs, funding and investment objectives. This is incorporated into the Strategic Investment Allocation Benchmark (SIAB), bands and benchmarks. Risk taken against that benchmark is monitored by the Pensions Committee using a risk register and risk management tools as advised by the Fund's fund managers, investment advisers and the Fund's Actuary.

The fund is exposed to Investment, operational, governance and funding risks. These risks are identified, measured, monitored and then managed. This is carried out using risk registers with section responsibility and oversight from the Chief Financial Officer.

The principal risks affecting the Fund are as follows:

Funding Risks Liabilities versus the Strategic Investment Allocation Benchmark (SIAB)

- a) The risk of deterioration in the funding level of the Fund. This could be due to assets failing to grow in line with the developing cost of meeting liabilities or economic factors such as unexpected inflation increasing the pension and benefit payments.

The Fund manages this risk by setting a strategic asset allocation benchmark assisted by the Fund's investment advisor. The strategic asset allocation benchmark seeks to achieve the appropriate balance between generating the required long-term return, while taking account of market volatility and the nature of the Fund's liabilities. It assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark.

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

The Fund 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.

- c) Systemic risk, i.e., the possibility of failure of asset classes and/or active investment managers results in an increase in the cost of meeting the liabilities.

The Fund mitigates systemic risk through a diversified portfolio with exposure to a wide range of asset classes, portfolio holdings and different management styles.

- d) Inflation risk the fund mitigates inflation risk through holding a portfolio of growth and inflation linked assets. Inflation risk is considered at least triennially in the setting of the SIAB and triennially as part of the actuarial valuation.

- e) Future Investment Returns (Discount rate) risk the funding and investment strategies are inter-linked and discount rate risk is mitigated through derivation based on the underlying long-term investment strategy. Discount rates are considered at least triennially in the setting of the SIAB and triennially as part of the actuarial valuation.

- f) Currency risk that the currency of the Fund's SIAB underperforms relative to sterling (i.e., the currency of the liabilities). The currency risk of the benchmark is considered at least triennially in the setting of the SIAB. Recommended changes will be expressed through changes in the benchmark and implemented by the investment managers

Asset Risks (the portfolio versus the SIAB)

- a) Concentration risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- b) Illiquidity risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- c) Currency risk that the currency of the Fund's assets underperforms relative to the SIAB.
- d) Manager underperformance when the fund managers fail to achieve the rate of investment return assumed in setting their mandates.
- e) Responsible Investment (RI) risks, including climate-related risks, that are not given due consideration by the Fund or its investment managers.

The Fund manages these asset risks by: -

- Constraining how far Fund investments deviate significantly from the SIAB by setting diversification guidelines and the SIAB strategic ranges.
- 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 Fund's expected parameters.
- By investing across a range of liquid assets, including quoted equities and bonds; the Fund has recognised the need for some access to liquidity in the short term.
- Robust financial planning and clear operating procedures for all significant activities including regular review and monitoring manager performance against their mandate and investment process.
- In appointing several investment managers, the Fund has considered the risk of underperformance by any single investment manager.
- The Fund actively addresses environmental, social and governance (ESG) risks through implementation of its Responsible Investment (RI) beliefs.

The Fund is aware that investing in overseas equities introduces an element of currency risk, but given the level of diversification within the Fund, the Pensions Committee is comfortable taking this risk in general but may act to mitigate potentially significant risks as and when they are identified.

The Fund invests in accordance with the investment restrictions stipulated by the Local Government Pension Scheme Regulations.

Operational Risk

- a) Transition risk of incurring unexpected costs in relation to the transition of assets amongst managers.

When carrying out significant transitions, the Fund takes professional advice and considers the appointment of specialist transition managers to mitigate this risk when it is cost effective to do so.

- b) Risk of a serious operational failure by asset managers and/or LGPS Central

These risks are managed by having robust governance arrangements with LGPS Central and by quarterly monitoring with asset managers

- c) Custody risk of losing economic rights to Fund assets, when held in custody or when being traded.

These risks are managed by:

- The use of a global custodian for custody of assets.
- The use of formal contractual arrangements for all investments.

When the Fund's investments are pooled in LGPS Central, the Asset servicer contract will include depositary protection over investment vehicles.

- d) Credit default with the possibility of default of a counterparty in meeting its obligations. The Fund monitors this type of risk by means of:

- Maintaining a comprehensive risk register with regular reviews.
- In-depth due diligence prior to making any investment.

The Fund monitors and manages risks in all areas through a process of regular scrutiny/oversight and reporting of KPIs of its service providers and audit of the operations they conduct for the Fund.

- e) Cashflow management risks

The Fund is becoming more mature and although its cashflow has been positive after taking investment income, the table below shows that this will not be the case in 2021/22 due mainly to the impact of several employers who will be paying their contributions 3 years in advance in 2020/21 and the improved overall funding position. Therefore, managing cashflow will become an increasingly important consideration in setting the investment strategy. Mitigating actions are already being taken to manage the cashflow shortfall such as investing in assets that produce cashflows such as Property, Infrastructure and fixed income that can be used to meet these payments.

The table below sets out the cashflow position of the Fund over the last six fiscal years and is continually monitored.

Cashflow Management	2021-22	2020-21	2019-20	2018-19	2017-18	2016-17
	£'M	£'M	£'M	£'M	£'M	£'M
Contributions receivable	60.7	170.7	87.7	81.8	185.2	107.8
Benefits Payable	-122.7	-117.0	-111.5	-106.3	-98.0	-95.5
	-62.0	53.7	-23.8	-24.5	87.2	12.3
Investment income	50.0	50.0	48.3	51.7	35.8	29.4
Net Cashflow	-12.0	103.7	24.5	27.2	123.0	41.7

4. Investment Strategy

Funding Policy

The objectives of the Worcestershire funding policy are expressed in its FSS. The Fund has a strong employer covenant, being funded largely by tax-raising local authorities. Therefore, the Committee can adopt a long-term view, without concern about the ability of its sponsors to meet their liabilities.

Given the on-going restructuring of public bodies the Fund is now maturing increasingly faster. Positive cashflow are declining (investment income is available if the Fund does go Cashflow negative) and this position is being closely monitored. However, at this time it is not felt necessary to change the investment strategy of the Fund.

As the Fund has a deficit of assets against liabilities (91% funded at the 2019 Triennial Valuation), the Committee wishes to achieve the maximum assistance from investments in reducing this shortfall. This would suggest a higher risk strategy to generate returns, but this is moderated by the realisation that such a strategy can also lose significant amounts of money in the short-medium term.

It is all the employer organisations in the Fund who feel the result of unstable employer rates, and for the precepting authorities, ultimately the local taxpayer either through the Council Tax or through service levels. Therefore, another very important consideration is the need for relative stability of investment returns, given that employee rates are fixed by statute and the tools available in the actuarial valuation process for smoothing of returns are limited. This can be achieved by investments that are inherently more stable, such as bonds. However, it is also aided by diversification (so that the ups and downs on particular investments do not arise together), and by seeking returns from both markets ("beta") and investment managers ("alpha") whose returns are skill based and relatively independent of the market.

Consequently, the Committee has set an overall investment goal that reflects these four factors.

Investment Strategies / Pots

In order that the Fund delivers on its key objectives (ensuring that each employer takes the appropriate level of investment risk, giving each the best opportunity possible to achieve its long-term funding objective whilst increasing certainty of cost), the Fund has introduced three distinct investment strategies (High, Medium and Low risk). These are detailed in Appendix A

Each investment strategy has its own strategic asset allocation benchmark. The strategic benchmark is consistent with the Fund's views on the appropriate balance between generating required long-term returns, whilst taking account of market volatility, risk and the nature of the Fund's liabilities.

The Fund is required to monitor its investment strategy relative to the agreed asset allocation benchmark in order to ensure that it remains consistent with the overall objective. The Fund undertakes a fundamental review of the strategic asset allocation every three years following actuarial valuations. The Fund also monitors compliance with this statement at least quarterly and monitors progress towards the long-term funding objective for relevant groups of employers on a regular basis.

In addition to the fundamental review of the strategic asset allocation undertaken every three years, the Fund will monitor progress of employers within the High and Medium Strategies on a regular basis. This gives the Fund the opportunity to adjust the strategic asset allocation in the event that a group of employers are ahead or behind their funding plan.

This is an important mechanism used by the Fund to ensure that each employer continues to take the appropriate level of investment risk, giving each the best opportunity possible to achieve its long-term funding objective whilst increasing certainty of cost. The progress of employers in Low Risk Strategy will be monitored every year as these employers are already invested in their "target funding plan".

A full explanation of the process undertaken to assess employer funding progress will be provided in the Fund's Investment Risk Management document which will be published on the website

Investment Goal

The Worcestershire Pension Fund's investment objective is to achieve a relatively stable "real" return above the rate of inflation over the long term, in such a way as to minimise and stabilise the level of contributions required to be paid into the Fund by employer bodies in respect of both past and future service liabilities.

Process for ensuring suitability of investments

The Committee has translated its objectives into a suitable strategic investment allocation benchmark (SIAB) and structure for the Fund (set out in Appendix A) considering both the liability structure and the objectives set out above. The Fund benchmark is consistent with the Pensions Committee's views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities. The Investment beliefs in appendix D also assist in formulating the investment strategy.

The Pension Committee monitors investment strategy relative to the agreed asset allocation benchmark and strategic ranges. If ranges are breached, then appropriate action is taken by the Chief Financial Officer. In addition to ongoing monitoring the investment strategy is formally reviewed annually by Pensions Committee. Furthermore, specific consideration is given to investment strategy in the light of information arising from each triennial actuarial valuation. The Investment Sub Committee will be monitoring asset allocation on a quarterly basis.

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. Appendix A shows the Strategic Investment Allocation Benchmark (SIAB) and strategic ranges.

6. Day-to-Day Management of the Assets

Investment management structure

The Pensions Committee retains responsibility for the investment strategy of the scheme but has delegated oversight of its implementation to the Chief Financial Officer. The day to day management of the Funds' investments is delegated to the Fund's external Investment Managers.

External Investment Managers

The Fund 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 investment managers are required to comply with LGPS investment regulations.

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, money markets, traded options, financial futures and derivatives, alternative strategies including Infrastructure and Property Pooled Funds. The fund uses external managers to carry out stock lending 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 considered and are not listed above then approval will be sought from the Pensions Committee after receiving advice on its suitability and diversification benefits.

The Fund may also make use of contracts for difference and other derivatives either directly or in pooled funds when investing in these products, for the purpose of efficient portfolio management or to hedge specific risks.

The Fund, 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 Fund's investment 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 and a mix of asset types across a range of geographies in order to provide diversification of returns.

Expected Return on the Investments

Over the long-term, it is expected that the investment returns will be at least in line with the assumptions underlying the actuarial valuation (the discount rate). The individual mandates are expected to match or exceed the specific targets 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 Pensions Committee.

Additional Assets

Assets in respect of members' additional voluntary contributions are held separately from the main Fund assets. These assets are held with Scottish Widows and Utmost Life.

The Fund monitors, from time to time, the suitability and performance of these vehicles.

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's liquidity characteristics are monitored on a regular basis and the majority of the Fund's investments may be realised quickly if required. A number of the Fund's alternative investments in Pooled Infrastructure and Property Funds, may be difficult to realise quickly in certain circumstances. The Fund will ensure that the Liquidity of the investments is suitable to meet future cash flow requirements.

Monitoring the Performance of Fund Investments

The performance of the external investments is independently measured. In addition, officers of the Fund meet external investment managers (both segregated and pooled) regularly to review their arrangements and the investment performance. The Pensions Committee meets at least quarterly to review markets, asset classes and funds.

7. Day-to-Day Custody of the Assets

The Fund has appointed a global custodian with regard to the safekeeping of the assets in the Fund and other investment administrative requirements.

8. Stock lending

Stock lending is undertaken in respect of the Fund's quoted equities holdings through the custodian / asset servicer. There is a formal stock lending agreement and approved collateral. Stock lending may also take place in pooled investment vehicles held by the Fund.

For the assets managed by LGPS Central on the Funds behalf, the Company has an active securities lending programme. To ensure that the Company can vote its shares at important meetings, it has worked with service providers to establish procedures to restrict lending for certain stocks and recall shares in advance of shareholder votes. The Company monitors the meetings and proportion of the securities on loan, and will restrict and/ or recall lent stock in select circumstances, with due consideration to the advantages of voting the shares versus the cost implications of recalling or restricting the loan of the stock

9. Approach to Pooling

The Fund has joined 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 Pension Fund assurance that its investments are being carried out effectively.

LGPS Central Ltd has been set up as an arms-length company, accredited by the Financial Conduct Authority, to manage the pooled investment assets of eight LGPS funds across the centre of England. The Worcestershire Pension Fund is one of the eight partner funds, all of whom hold equal shares in the company. LGPS Central started trading on 3rd April 2018 and all partner funds will gradually start to migrate assets to the company over the next few years.

The Fund is participating in the LGPS Central pool with the belief that the Fund will benefit from lower investments costs achieved through the aggregation of assets. In addition, the Fund will have greater access to a broader range of investable asset classes, including new and innovative products and services. LGPS Central and the partner funds have put in place a robust governance framework to ensure the company operates effectively and delivers timely and transparent reporting to shareholders and client funds.

The Fund will retain full responsibility and control over its strategic investment allocation policy with LGPS Central being responsible for implementing the strategy via the engagement and dismissal of managers and the day to day monitoring of manager investment performance. Subject to satisfactory due diligence and value for money considerations being satisfied, the Fund intends to continue to invest its assets with LGPS Central. Investment strategy will be determined by the fund with advice from the fund manager/operator and Independent adviser.

10. Responsible Investment (RI) and Stewardship

What do we mean?

The term 'responsible investment' refers to the integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes. It has relevance both before and after the investment decision and is a core part of our fiduciary duty. It is distinct from 'ethical investment', which is an approach in which the moral persuasions of an organisation take primacy over its investment considerations.

We define the concept of stewardship in the same way as the Financial Reporting Council (FRC), the organisation that oversees the UK Stewardship Code which was updated in 2020:

"Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society"

Responsible Investment and LGPS Central

From 1 April 2018 the implementation of the Fund's investment strategy was undertaken by LGPS Central, an investment management company set up by 8 Local Authorities (including Worcestershire County Council) in line with the latest scheme regulations. The Fund will seek to ensure that LGPS Central is set up to deliver objectives of this RI policy alongside that of the other Funds involved.

It is expected that the Fund's ability to invest in a responsible way will be enhanced through LGPS Central due to the inherent benefits of scale, collectivism and innovation that will result from the project. In order to broaden its stewardship activities, LGPS Central has appointed EOS by Federated Hermes (EOS) as its (LGPS Central's) stewardship provider, with the remit of engaging companies on ESG issues, and executing the LGPS Central Voting Principles (see below).

RI Beliefs and Guiding Principles (See Appendix D)

The Fund's RI Beliefs (see Appendix D) underpin its RI approach. Taking these beliefs as foundational, the Fund has adopted two RI aims: (1) primarily, to support the Fund's investment objectives; (2) secondarily, to be an exemplar for RI within the financial services industry and raise standards across the marketplace.

The Fund intends to realise these aims through actions taken both before the investment decision (which we refer to as the **Selection** of investments) and after the investment decision (the **Stewardship** of investments). Actions will be taken with reference to an evidence base, using the best available objective data sets. We aim to be **Transparent** to all stakeholders and accountable to our clients through regular **Disclosure** of RI activities, using best practice frameworks where appropriate. These ambitions yield the Fund's three RI pillars: Selection, Stewardship and Transparency & Disclosure.

Selection

The Fund believes that effective management of financially material RI risks should support the Fund's requirement to protect returns over the long term. Investment managers will seek to incorporate RI into their investment process. With regard to climate change risks, the Fund recognises that the scale of the potential impacts is such that a proactive and precautionary approach is needed in order to address them. The Fund considers RI to be relevant to the performance of the entire Fund across asset classes.

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.

The Fund recognises the need to operate at a market-wide level to promote improvements that will help it to deliver sustainable long-term growth.

- The Fund will set longer-term performance objectives for its investment managers.
- The Fund will seek to ensure that its long-term interests are aligned with that of its investment managers on all issues including on ESG considerations.
- Policies relating to ESG will be considered as part of the Fund's long-term investment planning process, following a thorough and robust investment appraisal.

We will use an **evidence-based** long-term investment appraisal to inform **decision-making** in the implementation of RI principles across our Investment strategy to make better more informed investment decisions and encourage / influence better corporate practices that lead to value creation and good risk management

- The Fund will consider the potential financial impact of ESG related issues on an ongoing basis (e.g. climate change or executive remuneration).
- The Fund will consider the potential financial impact of investment opportunities that arise from ESG related factors (e.g. investment in renewable energies or housing infrastructure).
- The Fund will consider investment opportunities that have positive impacts and recognises that the changing external environment presents new opportunities i.e. Renewable energy and social impact investments

Stewardship

Engagement

Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. The Fund adopts a policy of risk monitoring and engagement with companies on financially material RI issues, in order to positively influence company behaviour and enhance shareholder value; influence that would be lost through a divestment approach. The Fund extends this principle of “engagement for positive change” to the due diligence, appointment and monitoring of external fund managers.

The Fund believes that it will improve its effectiveness by acting collectively with other like-minded investors because it increases the likelihood that it will be heard by the company, fund manager or other relevant stakeholder compared with acting alone. To this end, the Fund uses its membership of the Local Authority Pension Fund Forum (LAPFF) and being a partner to the LGPS Central pool to assist it in pursuing engagement activities.

The Fund will engage investee companies on issues, including ESG issues that are material to long term value creation and robust risk management in order to safeguard and grow the Fund

- The Fund is committed to compliance with the UK Stewardship Code¹ and working within the spirit of the Principles of Responsible Investment (“PRI”).
- We will hold our investment managers to account to ensure compliance with this policy
- The Fund is committed to collective engagement through its membership of the Local Authority Pension Fund Forum (LAPFF), the LGPS Central pool and other opportunities that arise from time to time.
- The Fund will exercise its voting rights in all markets where practicable

Shareholder Voting

On the 21st June 2019 the Pensions Committee agreed that LGPS Central would via EOS vote shares in certain discretionary and pooled funds on the Fund’s behalf. These votes will be executed in line with LGPS Central’s published [Voting Principles](#). The Fund believes that the advantage of a consistent signal and working collectively through the pool will have a positive influence on company behaviour.

Shares held in passively managed portfolios will be voted according to the voting policies of the Fund’s appointed fund manager, Legal & General Investment Management (LGIM). The Pension Committee is satisfied that LGIM’s approach to shareholder voting is sufficiently robust and aids in the delivery of the Fund’s RI objectives.

Transparency & Disclosure

The Fund is committed to the UK Stewardship Code and has provided a statement of compliance which has been approved by the Financial Reporting Council (FRC).

<http://www.worcestershire.gov.uk/worcestershirepensionfund/download/downloads/id/97/stewardship-compliance-statement.pdf>

The 2020 version of the UK Stewardship Code was published in November 2019 and is “effective” from January 2020. The Fund intends to align its disclosure so as to achieve compliance with the 2020 version of the Stewardship Code.

LGPS Central provides quarterly reporting for all funds managed by LGPS Central detailing how votes have been cast in different markets and a vote by vote disclosure for full transparency. Engagement and voting disclosure is also done specifically for listed securities held across Worcestershire Pension Fund portfolios

How will we monitor our performance on Responsible Investment?

The Fund will ultimately be **transparent and accountable** in terms of its performance on Responsible Investment. This will be achieved through the following approach:

- The Fund will publish its Investment Strategy Statement on its website in line with the scheme regulations.
- Decisions relating to the setting of investment policy will be explained.
- The Fund will monitor closely its appointed investment managers whom the Fund rely on to implement its RI policy.
- The Fund will undertake an annual review of corporate governance, voting and engagement activity undertaken by the Fund and its underlying managers.
- The Fund will publish an annual summary of voting and engagement activity
- The Fund will ensure that its decision makers are properly trained and kept abreast of ESG issues to make informed decisions.
- The Fund will include ESG as standing item on Pensions Investment Sub Committee (or equivalent) agendas (with a view to reporting on manager performance in relation to ESG investing and noting any hot topics / issues arising).
- The Fund will undertake a fundamental review of any specific ESG issues that are considered by the Investment Sub Committee to be of potentially material financial impact.
- The Fund will consider and respond to feedback from stakeholders in relation to issues of concern.

11. Compliance with This Statement

The Fund will monitor compliance with this statement. It will ensure its investment decisions are exercised with a view to giving effect to the principles contained in the statement, so far as is reasonably practicable.

12. 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 identifying 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 the Fund continues to support and comply with them. Details of compliance are set out in the Fund's Governance Compliance Statement within the Annual Report, which can be found on the Fund's website.

List of Appendices

Appendix A – Strategic Allocation Investment Benchmark (SIAB) and Ranges.

Appendix B – Roles and Responsibilities

Appendix C – List of Advisers

Appendix D – Statement of Investment Beliefs

Appendix A – Strategic Allocation Investment Benchmark and Ranges

	High	Medium	Low	
Asset Allocation	%	%	%	Manager, Method & Performance Target
Actively Managed Equities				
Far East Developed	10.0	5.0	0.0	Nomura Asset Management - FTSE All World Asia Pacific Index + 1.5%
Emerging Markets	10.0	5.0	0.0	LGPS Central active global emerging markets equity mandates with BMO, UBS and Vontobel - FTSE - Emerging Market Index +2.0%
Passively Managed Equities - Market Capitalisation Indices				
United Kingdom	20.5	15.5	0.0	Legal and General Asset Management - FTSE All Share Index
North America	8.0	5.5	0.0	Legal and General Asset Management - FTSE All World North America - Developed Series Index
Europe ex - UK	6.5	4.0	0.0	Legal and General Asset Management - FTSE All World Europe ex UK Index - Developed Series Index
Passively Managed Equities – Alternative Indices				
Global	15.0	5.0	0.0	Legal and General Asset Management: - 40% GPAE - FTSE-RAFI Dev. 1000 Equity Fund - 30% GPBK - MSCI World Mini Volatility Index - 30% STAJ - CSUF - STAJ MF36726/36727
Actively Managed Bonds				
Fixed Interest	10.0	30.0	50.0	- LGPSC Global Active Investment Grade Corporate Bond (Fidelity & Neuberger Berman) - Fund 50% GBP IG Corporate (Ex EM Issues) / 50% Global IG Corporate ((ex IG Corporate & EM Issues) hedged to GBP +0.80% - EQT Corporate Private Debt
Actively Managed Alternative Assets				
Property & Infrastructure	20.0	20.0	20.0	Through a mix of Green Investment Bank, Invesco, Hermes, Walton Street and Venn Partners, Stonepeak, Firststate, AEW etc
TOTAL	100.0	100.0	100.0	

Tolerance Ranges

Asset Type	High	Medium & Low	Role (s) within the Strategy
Equities	+/- 5%	+/-2.5%	Long term growth more than inflation expected; generate investment income i.e. dividends.
Growth Fixed Income	+/- 5%	+/-2.5%	Provide protection from changes in real yields both in terms of capital value and income
Property	+/- 5%	+/-2.5%	Diversification; generate investment income; provide some inflation-sensitive exposure; illiquidity premium
Infrastructure			Provides the Fund with access to a diversified (but long term, illiquid) return source and a stream of inflation related income
Index Linked Gilts	+/- 5%	+/-2.5%	Provide protection from changes in real yields both in terms of capital value and income
Diversified Growth / Multi Asset	+/- 5%	+/-2.5%	Diversification and dynamic asset allocation

Appendix B - Roles and Responsibilities

Pension Committee

The Pension Committee discharges the responsibilities of the Council as Administering Authority of the Fund pursuant to Section 101 and Regulations under Section 7 of the Superannuation Act 1972.

The Pension Committee discharges the responsibilities for management of the administration of the Fund. However, it will take views from the Investment sub committee to enable it to discharge its duties effectively.

The Pension Committee discharges the responsibilities for the strategic management of the Fund's assets. However, it will take strategic advice from the Investment Sub Committee to enable it to discharge its duties effectively. The dates of Pension Committee meetings will be synchronised with those of the Pension Sub Committee to ensure investment decisions are reviewed without unnecessary delay.

The Council appoints the Chairman and Vice-Chairman of the Pension Committee. The Chairman of the meeting has a second or casting vote in the case of equality of votes.

The Pension Committee is a formal committee of the Council and comprises a total of 8 voting members:

- 5 Worcestershire County Councillors
- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund)
- 1 co-opted voting employer representative and
- 1 co-opted voting employee representative from a relevant Union.

The 5 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time to time and the nominations of the relevant Group Leaders and the 3 co-optees are co-opted by the Chairman of the Committee.

The Pension Committee will be advised by on a regular basis by an Independent Financial Adviser and the Fund's Actuary.

Pension Committee Terms of Reference:

The Pension Committee will meet at least quarterly or otherwise as necessary to take decisions on:

- Changes to the Investment Strategy Statement, including the strategic benchmark for asset allocation, Investment Manager benchmarks and Investment Manager targets.
- Transition of investments to LGPS Central or other Pooling arrangements
- The termination and appointment of Investment Managers and associated professional service providers.
- The termination and appointment of the Fund's Independent Financial Adviser, Performance Measurement Consultant, Global Custodian and Actuary.

- The Pensions Administration Strategy Statement, Policy Statement on Communication Strategy, Policy Statement on Governance Strategy, Funding Strategy Statement and Governance Compliance Statement.
- The Triennial and Interim Actuarial Valuations.
- The approval of the Pension Fund Annual Report and Accounts.
- The approval of the Pension Fund annual and triennial budgets.
- Key outstanding risks as identified in the Pension Fund Risk Register.
- The Pension Administration Advisory Forum arrangement and regular Forum reports, which consider and address outstanding member and employer issues and concerns.
- The Pension Sub Committee arrangement and regular Sub Committee reports, which monitor performance of the Fund's assets.
- Requests for admission of qualifying Community and Transferee Bodies wishing to join the Fund.
- Key pension policy discretions that are the responsibility of the Administering Authority.

All elected members and voting co-optees of the Pension Committee are subject to the Worcestershire County Council Code of Conduct for Members and must therefore register and keep updated their Disclosable Pecuniary Interests as required by the law and Code and disclose potential conflicts of interest as required by that Code.

Members of the Pension Committee are expected to hold the appropriate knowledge and skills to discharge their responsibility effectively – see Section 8.

The responsibility for advising the Pension Committee is delegated to the Chief Financial Officer.

Members of the Pension Committee have equal access to Pension Committee agenda papers and associated appendices in accordance with the legislation and constitutional Rules relating to access to information for committees. Formal meetings of the Committee will take place in public unless it has resolved to move into exempt session in accordance with the applicable access to information provisions.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 formally introduced the concept of asset pooling. Over time, as assets move into pooled structures the Pensions Committee will also become responsible for:

- The selection, appointment and dismissal of an investment pooling operator to manage the assets of the Fund;
- Determining what the administering authority requires the pool to provide to enable it to execute its local investment strategy effectively;
- Receiving and considering reports and recommendations from the Joint Committee and Practitioners Advisory Forum, established to oversee the pool, to ensure that the Fund's investor rights and views are represented effectively;
- Identifying and managing the risk associated with investment pooling;
- Ensuring that appropriate measures are in place to monitor and report on the ongoing costs of investment pooling; and
- Ensuring the responsible investment, corporate governance and voting policies of the Fund are delivered effectively.

Local Pensions Board

The purpose of the Board is to assist the Administering Authority in its role as a scheme manager of the Scheme. Such assistance is to:

- a) secure compliance with the Regulations, any other legislation relating to the governance and administration of the Scheme, and requirements imposed by the Pensions Regulator in relation to the Scheme and;
- b) to ensure the effective and efficient governance and administration of the Scheme.

The Board consists of eight members appointed by the Chief Financial Officer, as follows:

- Four Member Representatives; and
- Four Employer Representatives.

The Pensions Board is not a decision-making body, nor does it hold a scrutiny function.

Core functions

The first core function of the Board is to assist the Administering Authority in securing compliance with the Regulations, any other legislation relating to the governance and administration of the Scheme, and requirements imposed by the Pensions Regulator in relation to the Scheme. Within this extent of this core function the Board may determine the areas it wishes to consider including but not restricted to:

- a) Review regular compliance monitoring reports which shall include reports to and decisions made under the Regulations by the Committee.
- b) Review management, administrative and governance processes and procedures to ensure they remain compliant with the Regulations, relevant legislation and in particular the Code.
- c) Review the compliance of scheme employers with their duties under the Regulations and relevant legislation.
- d) Assist with the development of and continually review such documentation as is required by the Regulations.
- e) Assist with the development of and continually review scheme member and employer communications as required by the Regulations and relevant legislation.
- f) Monitor complaints and performance on the administration and governance of the scheme.
- g) Review the application of the Internal Dispute Resolution Process.
- h) Review the complete and proper exercise of Pensions Ombudsman cases.
- i) Review the implementation of revised policies and procedures following changes to the Scheme.
- j) Review the arrangements for the training of Board members and those elected members and officers with delegated responsibilities for the management and administration of the Scheme.
- k) Review the complete and proper exercise of employer and administering authority discretions.
- l) Review the outcome of internal and external audit reports.
- m) Review draft accounts and Fund annual report.
- n) Review the compliance of particular cases, projects or process on request of the Committee.

- o) Any other area within the statement of purpose (i.e. assisting the Administering Authority) the Board deems appropriate.

The second core function of the Board is to ensure the effective and efficient governance and administration of the Scheme. Within this extent of this core function the Board may determine the areas it wishes to consider including but not restricted to:

- a) Assist with the development of improved customer services.
- b) Monitor performance of administration, governance and investments against key performance targets and indicators.
- c) Review the effectiveness of processes for the appointment of advisors and suppliers to the Administering Authority.
- d) Monitor investment costs including custodian and transaction costs.
- e) Monitor internal and external audit reports.
- f) Review the risk register as it relates to the scheme manager function of the authority.
- g) Assist with the development of improved management, administration and governance policies.
- h) Review the outcome of actuarial reporting and valuations.
- i) Assist in the development and monitoring of process improvements on request of Committee.
- j) Assist in the development of asset voting and engagement processes and compliance with the UK Stewardship Code.
- k) Any other area within the statement of purpose (i.e. ensuring effective and efficient governance of the scheme) the Board deems appropriate.

1. In support of its core functions the Board may make a request for information to the Committee regarding any aspect of the Administering Authority's function. Any such request should be reasonably complied with in both scope and timing.

In support of its core functions the Board may make recommendations to the Committee which should be considered, and a response made to the Board on the outcome within a reasonable period of time.

Worcestershire County Council Pension Investment Sub Committee (ISC)

The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

The Council appoints the Chairman and Vice-Chairman of the Pension Investment Sub Committee. The Chairman of the meeting has a second or casting vote in the case of equality of votes.

The Pension Investment Sub Committee is a formal committee of the Council and comprises a total of 6 voting members:

- 5 Worcestershire County Councillors
- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund) (voting)
- 1 co-opted employee representative from a relevant Union. (non-voting).

The 5 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time to time and the nominations of the relevant Group Leaders and the co-optees are co-opted by the Chairman of the Committee.

The ISC will be advised by an Independent Financial Adviser who will attend all meeting and on an ad hoc basis by the Fund's Actuary

The composition of the Pension Investment Sub Committee is intended to reflect the abilities and knowledge of the individuals in matters relating to the investment of the Fund's assets rather than political representation. All members of the Sub Committee are entitled to vote if necessary for the Panel to fulfil its role and provide advice to the Pension Committee regarding the administration of the fund's assets.

The responsibility for advising the Pension Committee is delegated to the Chief Financial Officer.

Terms of reference:

The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

The ISC may also be occasionally requested to by the Worcestershire County Council Pension Fund Committee to undertake research and report back on a specific investment area.

All decision taken, and recommendations will be reported back to the next available ordinary meeting of the Worcestershire County Council Pension Fund Committee in the form of the minutes of the ISC.

The ISC will be responsible for: -

- a. Reviewing strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee.
- b. Reporting regularly to Committee on the performance of investments and matters of strategic importance.
- c. Monitor investment managers' investment performance and recommend decision to terminate mandates on performance grounds to Committee.
- d. Monitor the Transition of investments to LGPS Central or other Pooling arrangements
- e. Researching and providing a report back to the Worcestershire County Council Pension Fund Committee on any specific investment areas requested.

The ISC will have delegated authority to:

- f. Approve and monitor tactical positions within strategic allocation ranges.
- g. Implement investment management arrangements in line with strategic policy including the setting of mandate parameters and the appointment of managers.
- h. Approve amendments to investment mandates within existing return and risk parameters.
- i. Delegate specific decisions to officers as appropriate.

The ISC would meet quarterly ahead of the main Committee meetings to review manager performance and make decisions within the strategic asset allocations agreed.

The ISC is advised by an Independent Financial Adviser who attends all meetings and on an ad hoc basis by the Fund's Actuary.

One of the regular quarterly meetings will include an annual meeting to consider the Fund's full year's performance.

The Fund's Investment Strategy Statement (ISS) sets out the arrangements in place for the management of the investments of the Worcestershire County Council Pension Fund.

The day to day management of the Fund's investments is divided between external Investment Managers, operating in accordance with mandates set out in the Investment Strategy Statement.

The Chairman of the Investment Sub Committee will attend the Pension Committee to ensure flow of information between the 2 bodies.

Members of ISC must not have a conflict of interest and are required to provide the Chief Financial Officer with such information as the Chief Financial Officer reasonably requires for the purposes of ensuring no conflict of interest exists prior to appointment to the ISC and on an ongoing annual basis.

Members of the ISC are required to hold the appropriate knowledge and skills to discharge their responsibility effectively.

Pension Administration Advisory Forum

The Pension Administration Advisory Forum provides the Pension Committee with advice concerning the administration of the Fund. It is neither a decision-making body nor formal committee and will not normally meet in public. No voting rights apply to the Pension Administration Advisory Forum as the purpose of the Forum is to provide transparency of information to scheme employers and for scheme employers to provide advice to, and raise concerns with, the employer representative.

The Pension Administration Advisory Forum comprises:

- all Fund employers who wish to attend following invitation by the Administering Authority
- the Fund's Actuary (ad hoc basis)
- the Administering Authority's Pensions Administration Manager and HR & OD Service Commissioning Manager
- and the employer representative and employee representative of the Pension Committee.

Pension Administration Advisory Forum Terms of Reference:

The Forum meets at least twice a year or otherwise as necessary to:

- Discuss an Annual Administration Report and respond to any issues raised by employers.
- Discuss Government Consultations relating to the administration and benefits of the LGPS.
- Discuss the outcomes of the triennial/interim valuations and respond to any issues raised by employers.
- Discuss the minutes and updates from the Pension Committee and ensure flow of information between the Pension Committee and the Forum.
- To advise on service delivery to all stakeholders.
- To bring stakeholders perspective to all aspects of the Pension Fund business.
- To ask the Administering Authority and the Pension Committee to consider topics which affect the Pension Fund.

Appendix C - Advisers as of March 2020

MJ Hudson Allenbridge– Philip Hebson

Investment policy, general investment matters.

Mercers

Actuarial matters

Local Authority Pension Fund Forum (LAPFF)

Company governance issues.

BNY Mellon

Custodian, Stock lending.

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. 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.
- Listed Equities are expected to generate superior long-term returns relative to Government bonds and our beliefs in this Listed Equities are expanded below: .
 - a. Passively managed market cap-based investment has a balancing role to play in most pension schemes' equity allocations, bringing liquidity, transparency and reducing average fee levels;
 - b. Market cap weighted indices have their drawbacks; adding carefully selected systematic, factor tilted equity strategies can improve risk-adjusted returns, benefiting from disciplined rebalancing (the "rebalancing premium");
 - i. Exposure to "valuation factors" can improve risk adjusted returns over time. Even if outweighed by technical factors in the short-term, diversified exposure to valuation-based factor tilts can add excess return per unit of risk over a reasonable timeframe;
 - ii. Exposure to the "low volatility factor" can reduce absolute equity volatility and improve risk-adjusted returns. Strategies can be implemented which manage downside risk while achieving market returns over time;
 - iii. Exposure to the "small size factor" can improve risk-adjusted returns. A diversified tilt towards medium and smaller sized businesses is generally rewarded over time;

- iv. Carefully selected exposure to actively managed growth strategies can improve the balance of overall equity exposure and improve risk adjusted returns;
 - c. Exposure to emerging markets provides diversification and the opportunity for higher returns due to the higher risk premium typically earned for investing in these markets;
 - d. With sufficient research and governance, active equity management can be incorporated to add value relative to market cap weighted indices; overall active equity exposure should be focused predominantly on stock-specific risk;
 - e. Currency exposure associated with investing in equities can add volatility. Whilst it can be desirable to retain exposure to some currencies, hedging a proportion of non-domestic currency exposure can reduce the volatility of equity investing;
- 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 managers who consistently out-perform the relevant benchmark. 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 less 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's 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 pension Fund.

Responsible Investment Beliefs

- **Long termism:**

A long-term approach to investment will deliver better returns and the long-term nature of the Fund's liabilities allows for a long-term investment horizon

- **Responsible investment:**

Responsible investment is supportive of risk adjusted returns over the long term, across all asset classes. Responsible investment should be integrated into the investment processes of the Fund and its investment managers.

- **Diversification, risk management and stewardship:**

Diversification across investments with low correlation improves the risk return profile. A strategy of engagement, rather than exclusion, is more compatible with fiduciary duty and more supportive of responsible investment, because the opportunity to influence companies through stewardship is waived in a divestment approach. Even well diversified portfolios face systematic risk. Systematic risk can be mitigated over the long-term through widespread stewardship and industry participation.

- **Corporate governance and cognitive diversity:**

Investee companies and asset managers with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is clear evidence showing that decision making, and performance are improved when company boards and investment teams are composed of cognitively diverse individuals.

- **Fees and remuneration:**

The management fees of investment managers and the remuneration policies of investee companies are of significance for the Fund, particularly in a low return environment. Fees and remuneration should be aligned with our long-term interests, and value for money is more important than the simple minimisation of costs.

- **Risk and opportunity:**

Risk premia exist for certain investments; taking advantage of these can help to improve investment returns. There is risk but also opportunity in holding companies that have weak governance of financially material ESG issues. Opportunities can be captured so long as they are aligned with the Fund's objectives and strategy, and so long as there is a sufficient evidence base upon which to make an investment decision.

- **Climate change¹:**

Financial markets could be materially impacted by climate change and by the response of climate policymakers. Responsible investors should proactively manage this risk factor through stewardship activities, using partnerships of likeminded investors where feasible.

¹By highlighting climate change, rather than other RI risk factors, we are not asserting that climate risk has, for all assets, greater economic significance than other factors. Our motivation for referring specifically to climate change risk derives from our recognition that it is a risk factor of particular importance to several stakeholders, and we have communicated our investment beliefs about climate change for reasons of transparency.