ITEM 9

NORTH YORKSHIRE COUNTY COUNCIL

PENSION BOARD

20 JULY 2017

INVESTMENT STRATEGY STATEMENT

1.0 PURPOSE OF THE REPORT

1.1 To update Pension Board Members on the progress made on the latest draft of the Investment Strategy Statement (ISS).

2.0 BACKGROUND

2.1 To remind Pension Board members, the LGPS (Investment and Management of Funds) Regulations 2016 came into force on 1 November 2016, replacing the 2009 Regulations. A new requirement of these Regulations was that administering authorities are required to have an Investment Strategy Statement (ISS) and that it be first published no later than 1 April 2017. This requirement replaces the previous requirement to maintain a Statement of Investment Principles (SIP).

2.2 The first draft of this document was taken to the February PFC meeting where it was approved. It was then sent to employers for consultation, there were no changes required from this. It was also circulated to the Pension Board for comments which were reflected in the initial document to be published. The document was published on the website prior to the deadline.

2.3 It was agreed at the February PFC meeting that as the ISS is a fluid document an updated version would be taken to the Pension Fund Committee for approval at the 6 July 2017 meeting. At the 20 April 2017 Pension Board meeting the ISS was taken to provide Pension Board Members with the opportunity to input any further feedback to allow the ISS to be updated prior to the July PFC meeting.

2.4 Pension Board member comments were reflected in the latest version along with the feedback from the Independent Professional Observer who was asked to comment on the ISS. He made a number of observations, particularly in relation to pooling investments and policies which may change through coordinating the approach with partner Funds within Border to Coast Pensions Partnership. Specifically, points were made on:

- Setting out the proportion of assets that will be invested through pooling
- Summarising assets that would not be suitable for pooling
- Considering the views of interested parties when making investments decisions based on non-financial factors
- Explaining the approach to social investments
- Reporting on voting activity in the Annual Report
- Statement on investments in entities connected to the Administering Authority
- Statement on persons consulted in relation to the ISS

3.0 RECENT EVENTS

3.1 The latest amended version of the ISS (attached as **Appendix 1**) was taken to PFC on 6 July 2017 where it was approved subject to the following wording refinements:

- Paragraph 6.4 – minor wording amendments
- Include an additional paragraph following paragraph 6.4 around the shareholders of BCPP

4.0 RECOMMENDATION

4.1 Pension Board Members note the content of the report.

Appendix 1

NORTH YORKSHIRE PENSION FUND

INVESTMENT STRATEGY STATEMENT

TABLE OF CONTENTS

1.0 INTRODUCTION

1.1 Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the Regulations) requires administering authorities to formulate, publish and maintain an Investment Strategy Statement (ISS). This document is the ISS of the North Yorkshire Pension Fund (NYPF, or the Fund) for which North Yorkshire County Council (the Council) is the administering authority.

1.2 The Council has delegated all its functions as the administering authority of NYPF to the Pension Fund Committee (PFC, or the Committee). The Corporate Director - Strategic Resources, who reports to the Chief Executive, has day to day control of the management of all aspects of the Fund's activities.

1.3 The Committee determines the investment policy of the Fund and has ultimate responsibility for the investment strategy. The Committee undertakes its responsibilities after taking appropriate advice from external advisers.

1.4 The Committee seeks to invest in accordance with the ISS, any Fund money that is not needed immediately to make payments from the Fund. The ISS should be read in conjunction with the Fund's Funding Strategy Statement.

1.5 The Pension Board and the Fund's employers have been consulted on the drafting of this document.

2.0 OBJECTIVES OF THE FUND

2.1 The primary objective of the Fund is to provide pension benefits for members upon retirement and/or benefits on death for their dependents, on a defined benefits basis. Investments will therefore be selected with the aim of fully funding these benefit requirements over an extended number of years. The funding position will be reviewed at each Triennial Valuation with adjustments to the investment strategy, asset allocation and to investments with investment managers as required.

2.2 The investment objective of the Fund is to provide for sufficient capital growth of the Fund's assets in a range of market conditions, supplemented by employee and employer contribution income, to meet the cost of benefits as they fall due. It is translated into a suitable strategic asset allocation benchmark designed to address the nature of the Fund's liabilities, and deliver returns over the long term including through periods of volatility in financial markets.

3.0 INVESTMENT OF MONEY IN A WIDE VARIETY OF INVESTMENTS

3.1 The Committee reviews the investments of the Fund on a regular basis. The last review of the investment strategy took place in 2013 and there is an ongoing review of the strategy, alongside the 2016 Triennial Valuation, due to be completed in 2017. Additional reviews of individual asset classes have also taken place, with particular regard to diversification and suitability. The Committee receives advice from its Investment Consultant when undertaking such reviews.

3.2 These reviews provide a framework designed to produce the returns the Fund requires over the long term to meet its future liabilities. Each asset class invested in is allocated a range, and rebalancing takes place when values stray beyond them due to market conditions. Further rebalancing may take place based on tactical views of the Fund's advisers.

3.3 The Fund's current strategic asset allocation is set out below. The table also includes the ranges within which the asset allocation may vary without specific reference to the Committee, however in practice the allocation is considered by the Committee each quarter and adjustments made as necessary.

	Minimum %	Benchmark %	Maximum %
Equities	50	62	75
Alternatives	10	20	20
Fixed Income	15	18	30

3.4 The largest proportion of the Fund's investments are in equities which is aimed at growing the value of assets over the long term. Other return seeking asset classes complement this goal, with the allocation to liability matching assets providing a measure of protection against rising liability valuations.

3.5 Each asset class is sub-divided into two or more mandates with different investment managers and operating to different benchmarks, further increasing the diversification of the Fund's investments.

3.6 The most recent changes to the strategy have been the addition of Alternatives, being Property (2012), Diversified Growth Funds (2013) and Private Debt (2016). These asset classes have served to further diversify the Fund's investments, spreading risk and reducing short term volatility.

3.7 Each investment manager operates to a specific benchmark and to specific mandate restrictions appropriate to their process and style, so that in aggregate, their activities are aligned to the overall performance requirements and risk appetite of the Fund. Each manager holds a range of underlying investments which reflects their views relative to their respective benchmarks, as permitted by their mandates.

3.8 The investment management arrangements of the Fund are as follows.

Manager	**Mandate**	**Objective**
Standard Life	UK Equities	To outperform the FTSE 350 (excluding Investment Trusts) Equally Weighted Index by 3% pa over the long term
Baillie Gifford	Global Equities (Global Alpha)	To outperform the FTSE All World Index by 2% over the long term
Baillie Gifford	Global Equities (Long Term Global Growth)	To outperform the FTSE All World Index by 3% over the long term
Dodge & Cox	Global Equities	To outperform the MSCI All Country World Index over a market cycle
Veritas	Global Equities	To outperform CPI + 6% to 10% over the medium term
Fidelity	Overseas Equities	To outperform an MSCI geographically weighted index by 2% pa over the medium term
Newton	Diversified Growth Fund	To outperform LIBOR by 4% over the medium term
Standard Life	Diversified Growth Fund	To outperform LIBOR by 5% over the medium term
Hermes	UK Property	To outperform the IPD Other Balanced Property Funds Index by 0.5% over the medium term

Legal & General	UK Property	To outperform the IPD All Balanced Property Funds Index over the medium term
Threadneedle	UK Property	To outperform the IPD All Balanced Property Funds Index by 1% to 1.5% over the medium term
M&G	UK Government Bonds	To outperform liabilities by 0.5%
ECM	European Corporate Bonds	To outperform LIBOR by 3%
BlueBay	Private Debt	IRR of 9% gross (7% net) including 4.5% cash yield
Permira	Private Debt	IRR of 9% gross (8% net) including 5% cash yield

3.9 The Fund is permitted to invest up to 5% in entities connected to the administering authority. There are currently no such investments.

4.0 THE SUITABILITY OF PARTICULAR INVESTMENTS AND TYPES OF INVESTMENTS

4.1 The following categories of investment have been approved as suitable for the NYPF.

UK Equities provide a share in the assets and profitability of public companies floated on UK stock exchanges. Capital gains and losses arise as share prices change to reflect investor expectations at the market, sector and stock levels. Income is derived from dividends.

Overseas Equities are similar to UK Equities but allow greater diversification amongst markets, sectors and stocks. Valuations are affected by exposure to movements in the relative value of the foreign currencies in which investments are made against sterling. Exchange rates are likely to reflect differentials in inflation so should not affect returns materially over the long term, but over the short term currency movements may significantly add to or subtract from returns. Equities are expected to provide high returns compared to other asset classes (the "equity-risk premium").

Deleted: ; to address the NYPF deficit position a high proportion of assets will be held in equities

UK Bonds are debt instruments issued by the UK Government and other borrowers. Bonds provide a fixed rate of interest and are usually redeemed at a fixed price on a known future date. Valuations primarily reflect the fixed level of interest, the period to redemption and the overall return demanded by investors. They are vulnerable to rising inflation and correspondingly benefit from falling inflation.

Overseas Bonds are similar to UK Bonds but have exposure to currency exchange rate fluctuations. As with UK bonds they are influenced by local inflation rates.

Index Linked Bonds are bonds that provide interest and a redemption value directly linked to a measure of inflation, usually the Retail

	Price Index or a similar index. The returns from this asset class act as a useful proxy for movements in liability values.
Diversified Growth Funds	are an alternative way of investing in shares, bonds, property and other asset classes. These funds are managed by specialist multi-asset managers and target returns slightly below that of equities but with significantly reduced volatility due to the diversification of their constituent parts.
UK Property	is an investment in buildings, indirectly through pooled vehicles. Capital gains and losses occur as prices fluctuate in line with rental levels and investor demand. Income is generated from rents collected from tenants. The nature of rental agreements gives property some of the characteristics of bonds, whilst growth and inflation provide some of the characteristics of equities. It is, therefore, a useful diversifying asset class.
Private Debt	is loan arrangements provided directly to companies over the medium term for an index linked return, significantly above rates charged by commercial banks. Typically they are provided through pooled fund arrangements and require that investors commit funds for a period of 5 to 7 years, with income and capital being returned throughout that time.
Derivative Instruments	such as options and futures are mechanisms through which the Fund can be protected from sudden changes in share prices or exchange rates. Although not income producing they can result in capital gains and losses. They may be used to hedge the Fund's exposure to particular markets.
Cash	is invested in authorised institutions in accordance with the treasury management policy of the Council under the terms of a Service Level Agreement and attracts interest at market rates.

4.2 Each asset class has different return expectations and volatility characteristics. They are blended to produce the optimal investment return while taking an appropriate level of risk. Periodic investment reviews assess whether this blend requires adjustment, including through the addition of new asset classes, to take account of changing market conditions and the evolving asset and liability profile of the Fund. Tactical rebalancing also takes place, as required. All monitoring, reviews and rebalancing is undertaken after taking advice from the Fund's Investment Consultant.

4.3 The 2016 Triennial Valuation was prepared on the basis of an expected return on assets of 5.9% over the long term. This return is 1.5% above the discount rate used to calculate the Fund's liabilities and reflects a "probability of funding success" as described in the Funding Strategy Statement of 75%. This is based on the Fund's current asset mix and assumes no outperformance from active management.

5.0 THE APPROACH TO RISK, INCLUDING THE WAYS IN WHICH RISKS ARE TO BE MEASURED AND MANAGED

5.1 The Fund to aims to achieve its funding objective by taking an appropriate level of risk, through investing a proportion of funds in growth assets. Ongoing monitoring of the risk profile takes place including reassessing its appropriateness through investment strategy reviews and at the quarterly meetings of the PFC when appropriate. Close regard is paid to the ongoing risks which may arise through a developing mismatch, over time, between the assets of the Fund and its liabilities, together with the risks which may arise from any lack of balance/ diversification of the investment of those assets.

5.2 The risk of financial mismatch is that the Fund's assets fail to grow in line with the liabilities. It is managed by the Committee through a review of the assumptions used to calculate the Fund's liabilities at each Triennial Valuation, and an assessment by the Actuary of the Fund's asset allocation strategy of the probability of achieving funding success. This assessment forms the basis for subsequent asset allocation reviews aimed at controlling risk and further improving the funding position.

5.3 Longevity risk and other demographic factors are assessed at each Triennial Valuation. The Committee reviews national and Fund specific trends as part of this process.

5.4 Systemic risk, being the possibility that an event akin to the financial crisis occurs, is mitigated through the diversified nature of the Fund's asset allocation strategy. The Committee has taken steps since 2008 to spread investments across a larger number of asset classes which behave differently in different market conditions. The risks associated with individual asset classes, the combined nature of risks at Fund level are reassessed at each strategy review and changes made as appropriate.

5.5 This diversification across asset classes and across investment managers within each asset class significantly mitigates concentration risk, so that the effect of underperformance of any one asset class or investment manager is minimised. Rebalancing activity prevents departure from the strategic asset allocation benchmark.

5.6 The significant majority of the Fund's assets are invested in liquid investments, so that the risk of illiquidity, being an inability to meet liabilities as a result of a lack of liquid assets, is minimal. The risk is further managed by cashflow forecasting.

5.7 Currency risk is that the Fund's assets, the majority of which are overseas, underperform relative to Sterling. This risk is managed through a periodic assessment of currency exchange rates including receiving advice on the suitability of hedging the major currencies the Fund's assets are denominated in.

5.8 Agreements with the Fund's custodian and investment managers provide protection against fraudulent losses. In addition regular checks are undertaken by independent auditors of the custodian's and investment managers' systems. These organisations have internal compliance teams which also monitor and report on risk.

5.9 The Fund maintains a Risk Register which identifies the key risks, an assessment of the potential impact of each risk should it occur, and the controls and contingency plans in place to mitigate the likelihood and severity of each risk. The Risk Register is reviewed by the PFC annually and by the Pension Board semi-annually.

6.0 THE APPROACH TO POOLING INVESTMENTS, INCLUDING THE USE OF COLLECTIVE INVESTMENT VEHICLES AND SHARED SERVICES

6.1 The Fund is a member of the Border to Coast Pensions Partnership ("BCPP", or "the Pool"). The proposed structure and basis on which the BCPP will operate was initially set out in the July 2016 submission to Government and is currently under review as part of the plans for formal creation of the Pool vehicle.

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6.2 The key criteria for the assessment of the Pool are that it provides a suitable solution that meets the investment objectives and asset allocation strategy of the Fund and that there is significant financial benefit to joining the arrangements.

6.3 The change in arrangements is that the Pool will be responsible for manager selection and monitoring, which is currently a responsibility of the Committee. The responsibilities for determining the investment strategy and asset allocation strategy will remain with the Committee.

6.4 At the time of preparing this statement the details of the pooling arrangements are being finalised. However it is expected that approximately 96% of NYPF's assets will be transitioned into the Pool once suitable sub-funds are in place, and that certain illiquid investments, comprising approximately 4% will be retained by NYPF. The legal structures of these illiquid assets are such that it is not practical to transfer ownership without a substantial loss in value. New investments will be made through the Pool wherever possible.

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6.5 The July 2016 submission to Government of BCPP, available on the Fund's website www.nypf.org.uk, provided a statement addressing an outline structure and governance of the Pool, the mechanisms by which the Fund can hold the Pool to account and the services that will be shared or jointly procured. Government approved this approach on 12 December 2016. The Fund has subsequently been working with the BCPP to progress final arrangements.

6.6 Arrangements include establishing a Financial Conduct Authority regulated company to manage the assets of BCPP partner funds. Based on legal advice describing the options on holding shares in this company (BCPP Limited), the Fund will hold all voting and non-voting shares rather than the Council. This is because the purpose of the company is to meet the needs of the constituent Funds in complying with the regulations on pooling, rather than for a Council specific purpose.

6.7 The Fund will hold the Pool to account through having a representative on the Joint Committee, which as an investor will monitor and oversee the investment operations of BCPP Limited. It will also have a representative on the Shareholder Board, which will as an owner provide oversight and control of the corporate operations of BCPP Limited.

6.8 An annual report will be submitted to the Scheme Advisory Board providing details of assets transferred into the pooling arrangement.

6.9 As the Pool develops and the structure and governance of the Pool are established, the Fund will include this information in future iterations of the ISS.

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7.0 HOW SOCIAL, ENVIRONMENTAL OR CORPORATE GOVERNANCE CONSIDERATIONS ARE TAKEN INTO ACCOUNT IN THE SELECTION, NON-SELECTION, RETENTION AND REALISATION OF INVESTMENTS

7.1 The PFC takes the view that its overriding obligation is to act in the best financial interests of the Scheme and its beneficiaries. It is recognised that environmental, social and governance ("ESG") factors can influence long term investment performance and the ability to achieve long term sustainable returns. Investment advice received by the Fund implicitly includes these factors. Therefore, as a responsible investor, the Committee wishes to promote corporate social responsibility, good practice and improved performance amongst all companies in which it invests.

7.2 The Committee considers the financial impact of ESG factors on its investments through regular reporting by the Fund's investment managers. Engagement with company management and voting behaviour are integral to investment processes aimed at improving performance in companies in which they invest.

7.3 As well as delegating the Fund's approach to ESG issues to its investment managers, NYPF is also a member of the Local Authority Pension Fund Forum (LAPFF) which is the UK's leading collaborative shareholder engagement group. This organisation promotes ESG good practice on behalf of over 70 LGPS funds. Its activity acts as a complement to that undertaken by the Fund's investment managers. Any differences in approach are discussed with the Fund's investment managers so that the reasons are fully understood.

7.4 The Fund is compliant with the six principles on investment decision making for occupational pension schemes, as set out in the guidance published by the Chartered Institute of Public Finance and Accountancy in December 2009 called "Investment Decision Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles".

7.5 Any evaluation of social investments is made on the same basis as other investment opportunities, in taking into account financial and non-financial factors.

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8.0 THE EXERCISE OF RIGHTS (INCLUDING VOTING RIGHTS) ATTACHING TO INVESTMENTS

8.1 The Committee has delegated the exercise of voting rights to Pension Investment Research Consultants Limited (PIRC). Votes are executed by PIRC according to predetermined Shareholder Voting Guidelines agreed by the PFC, available on the Fund's website. These guidelines are aligned to the UK Stewardship Code and to best practice in other jurisdictions. Votes are cast for all UK equities held by the Fund, and for non-UK holdings where practicable. The Fund monitors voting decisions on a regular basis and a summary is included in the Fund's Annual Report.

8.*2* The Fund adheres to the Stewardship Code as published by the Financial Reporting Council. The Committee will expect both BCPP Ltd and any investment managers appointed by it to also comply with the Stewardship Code.

8.3 The Fund's collective engagement activity through the LAPFF supports the voting activity undertaken by PIRC.

8.4 The Fund aims to adopt the Principles of the Financial Reporting Council's UK Stewardship Code. A Statement of Compliance will be published on the Fund's website in 2017.

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