Investment Strategy Statement

Introduction

Hampshire County Council is the administering authority for the Hampshire Pension Fund (the "Fund"), which covers employees of the County Council, two unitary councils, 11 district councils, and 329 other scheduled and admission bodies. The total number of contributors is 57,815 and there are 59,857 deferred members and 36,519 pensioners.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require pension fund administering authorities to prepare and review, from time to time, an Investment Strategy Statement, which replaces the previous Statement of Investment Principles.

This Statement has been drafted to comply with these regulations in accordance with the Guidance on Preparing and Maintaining an Investment Strategy Statement.

Investment Strategy

The Fund has three main aims:

- To manage the employers' liabilities to achieve long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term.
- To enable primary contribution rates to be kept to nearly as constant as possible (subject to the administering authority not taking undue risk) at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies, while achieving and maintaining fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the Fund and employers, and the risk appetite of the administering authority and employers alike.
- Seek returns on investment within reasonable risk parameters.

In completing the Fund's 2016 Actuarial Valuation, the Fund's Actuary, Aon Hewitt advised that the Pension Fund requires the assets to deliver a long-term return of above the discount rate of 4.5%, which is set out in the Fund's Funding Strategy Statement.

Variety of investments

In order to achieve the return in its Funding Strategy, the Investment Regulations require the Pension Fund to invest money in a wide variety of investments and state the maximum percentage that it will invest in particular investments or classes of investment.

The strength of the majority of the Fund's employers' covenants and the present positive annual cashflows allow the Fund to have set a long term deficit recovery period and to take a corresponding long term view of investment strategy. For the purpose of setting maximum limits the Pension Fund has done this at a strategic level. The total is deliberately greater than 100% to allow flexibility between the categories. The allocation below favours growth assets as the Fund believes that participation in economic growth is a major source of long term equity returns, which will be required to meet its long-term investment return target and mean that employer contributions can be kept lower.

	Maximum %
Growth assets – primarily include investments in equity. They tend to carry higher levels of risk, yet have the potential to deliver higher returns over longer investment time frames.	80%
Matching assets – investments whose return mirrors the drivers of the Pension Fund’s liabilities, in particular inflation, such as Index-Linked Gilts and property.	50%

Suitability of investments and receipt of investment advice

The Pension Fund has access to the necessary skills, expertise and resources to manage the whole Fund. When making investment decisions the Pension Fund Panel and Board will take advice from appropriate specialist investment professionals including officers, consultants and independent advisors. The Panel and Board have appointed a permanent independent advisor (currently Carolan Dobson) to provide advice on all investment decisions.

The Pension Fund recognises the importance of ensuring that all staff and members charged with the financial management and decision making with regard to the Fund are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them. The members of the Panel and Board annually complete CIPFA’s training needs analysis for pension fund’s, which includes investments, and a training plan is prepared to meet the requirements identified. To fulfil the training needs of officers and members the Pension Fund will access training from a variety of investment professionals, including both companies that it does and does not currently contract with, in order to gain exposure to a wide variety of views.

Strategic Asset Allocation

To implement the Pension Fund’s Investment Strategy the Pension Fund Panel and Board sets a Strategic Asset Allocation with the aim of achieving the Fund’s overall long-term target return without exposing the Fund to excessive risk. In setting the Strategic Asset Allocation advice was commissioned from Aon Hewitt on the options for the Fund’s asset allocation and the most effective allocation for achieving the Fund’s target return with the degree of certainty specified in the Funding Strategy Statement.

Investment sector	Management style	% of Fund
Growth Assets		
Equities*	Active	40.0
	Passive	14.0
Global bonds	Active	5.0
Private equity and other	Direct	5.0
Infrastructure**	Direct	1.5
Hedge funds	Direct	3.5
		69.0
Matching Assets		
UK index-linked bonds	Passive	21.0
UK property	Direct	10.0
		31.0
Total		**100.0**

* equities are split 65/35 Global/UK
** an additional 3.5% is to be made available fund from passive equities for infrastructure investments if suitable opportunities can be found

The Strategic Asset Allocation was agreed in 2014 following the Fund's last triennial actuarial valuation and will be reviewed from time to time by the Panel and Board at least every 3 years following the actuarial valuation.

To manage the portfolios in the Fund's asset allocation the Pension Fund contracts with specialist external investment managers. No assets are managed internally, with the exception of the Fund's cash balance. Since the implementation of the Strategic Asset Allocation the Pension Fund has taken advice from Allenbridge Epic on the appointment of investment managers. The Fund's current investment managers are shown in Appendix 1.

Approach to risk

The Pension Fund has identified a number of risks on its risk register that may impact its funding and investment strategies, contained in Appendix 2, which is reviewed at least annually by the Panel and Board. The Pension Fund maintains a risk register to identity key risks, consider and assess their significance, likelihood of occurrence and potential impact of the risk.

The Panel and Board is aware that the Fund has a need to take risk (e.g. investing in growth assets) to help it achieve its funding objectives. The Fund's appetite for risk is to minimise the overall portfolio risk while delivering the target returns through a diversified portfolio.

Social, environmental and corporate governance considerations

The Hampshire Pension Fund has an overriding fiduciary duty in law to invest Fund monies to achieve the best possible financial return for the Fund consistent with an acceptable level of risk.

However, the Fund recognises that companies can enhance their long-term performance and increase their financial returns by adopting positive social, environmental and ethical principles in planning and running their activities.

The Fund has delegated to the external investment managers responsibility for taking social, environmental and corporate governance considerations into account when assessing the financial potential and suitability of investments. All of the investment managers contracted by the Hampshire Pension Fund are signatories to the UN Principles for Responsible Investment.

Where appropriate each investment manager is asked to work actively with companies to promote forward-looking social, environmental and corporate governance standards. This should not, however, deflect from the primary objective of achieving the best possible financial return for the Fund, in accordance with the Fund's fiduciary duty.

Exercise of rights attaching to investments

Investment managers have been instructed to exercise the Fund's responsibility to vote on company resolutions wherever possible.

Investment managers have also been instructed to intervene in companies that are failing (thus jeopardising the Fund's interests), by voting or by contacting company management directly.

The Fund believes that if companies comply with the principles of the UK Corporate Governance Code published by the Financial Reporting Council, this can be an important factor in helping them succeed; but the Fund also accepts the need for a flexible approach that is in the common long-term interests of shareholders, company employees and consumers. The Fund's investment managers should cast their votes with this in mind.

In particular, the Fund's investment managers should cast their votes to ensure that:

- executive directors are subject to re-election at least annually
- executive directors' salaries are set by a remuneration committee consisting of a majority of independent non-executive directors, who should make independent reports to shareholders
- arrangements for external audit are under the control of an audit committee consisting of a majority of independent non-executive directors, with clear terms of reference – these should include a duty to ensure that investment managers closely control the level of non-audit work given to auditors, and should not significantly exceed their audit-related fee unless there are, in any investment manager's opinion, special circumstances to justify it
- in the investment managers' opinion, no embarrassment is caused to the Fund in relation to its beneficiaries, Hampshire residents, or the general principles of the UK Corporate Governance Code.

If investment managers do not follow these guidelines, they must report to the Pension Fund explaining why.

Approach to pooling

Hampshire is a member of the ACCESS pool along with the following 10 other pension funds:

- Cambridgeshire
- East Sussex
- Essex
- Hertfordshire
- Isle of Wight
- Kent
- Norfolk
- Northamptonshire
- Suffolk
- West Sussex

All eleven funds are committed to collaboratively working together to meet the criteria for pooling and have signed a Memorandum of Understanding to underpin their partnership. ACCESS is working to a project plan in order to create the appropriate means to pool investments. The first investments to be pooled in 2017 will be passively managed investments.

The ACCESS Funds have set out how they meet the pooling criteria, the pool's structure, governance arrangements and services to be shared in the submission made to the Government in July 2016, which is available on ACCESS' website http://www.accesspool.org/

All 11 ACCESS funds are working in the expectation that all investments will be pooled apart from a minority of investments where there is no value for money benefit to pooling a specific investment as identified and agreed by an individual fund.

Hampshire will not be pooling its allocation to directly held UK property (10% of its Strategic Asset Allocation). As set out by the ACCESS funds in their July 2016 submission to the Government, there is a dis-economy in pooling direct property investments due to the cost (principally tax) of making changes to portfolios and the limited anticipated savings available from pooling.

In addition Hampshire will not pool cash held for the efficient administration of the scheme, which is needed to manage cash flow to meet statutory liabilities including monthly pension payroll payments.

Appendix 1 – Investment management arrangements

Portfolio	Investment Manager	Benchmark	Annual target performance gross/net of fees
Low-risk active UK equities	Schroder Investment Management	FTSE All Share	+1.25% gross
High-performance global equities	Acadian Asset Management	MSCI World Index	+1.5-2.5% net
	Baillie Gifford	MSCI ACWI	+1.5-2.5% net
	Newton Investment Management	MSCI ACWI	+1.5-2.5% net
	Standard Life	MSCI ACWI	+1.5-2.5% net
Passive Global Equities	State Street Global Advisors	FTSE All World Equity Index	
Passive UK Equities	State Street Global Advisors	FTSE All Share	
Active global bonds	Western Asset Management	Barclays Capital Global Aggregate Bonds Index	+1.5% gross
Private equity	Aberdeen Asset Management		+9%-11.5% net
Hedge funds	Morgan Stanley		+5.5%-8% net
Infrastructure	Grosvenor Capital Management		+7.5%-10% net
Passive UK index-linked bonds	Legal & General	FT British Government Over Five Years Index-Linked Gilts Index	
	State Street Global Advisors	FT British Government Over Five Years Index-Linked Gilts Index	
UK property	CBRE Global Investors	Retail Price Index (RPI)	+4.5% net
European property (legacy portfolio)	Aberdeen Asset Management	Eurozone Harmonised Index of Consumer Prices (HICP)	+5% net

Appendix 2 – Investment Risk Register

Risk description	Approach	Mitigation
Investment management underperformance – from the Fund's investment managers failing to outperform their benchmark returns for prolonged periods of time	The Pension Fund believes that for certain asset classes active investment management can add value. It acknowledges that there will be periods where even the best active managers underperform the market but that any investment decisions must be made with a long-term perspective on previous and expected investment returns.	For asset classes where active management can add value the Pension Fund will consider a range of investment strategies from higher performance/risk, lower volatility and passive management. The Fund's investment managers' performance is reviewed regularly by the Fund's officers and reported regularly to the Panel and Board. The Fund's active investment managers report to the Fund on their actions in managing the Fund's investments at least four times a year, including at least once to the Panel and Board. All of the Fund's contracts for investment management contain the provision that the Fund can cancel the contract with 1 months notice in the event of poor investment performance.
Market risk – from fluctuations in market prices, which is particularly relevant for investments in equities	The Pension Fund is a long term investor, and as such can ride-out short term fluctuations in markets in order to participate in long term growth that will deliver returns for the Fund.	The Panel and Board have set a diversified asset allocation which limits exposure to one particular market. The Fund contracts with specialist external investment managers and as a general principle aims to invest globally and set mandates for investment managers that give them as much freedom as possible, in order to manage market conditions as they see fit.
Interest rate risk – which can affect the prices of investments that pay a fixed interest rate	The Pension Fund considers that investments paying a fixed rate of interest (generally bonds) offer an important source of diversification from equities.	The Fund contracts with specialist external investment managers and as a general principle aims to set mandates for investment managers that give them as much freedom as possible, in order to manage risks such as changes in interest rates.
Currency risk – the risk of fluctuations in prices of financial instruments that are	As a long term investor the Pension Fund accepts that currencies will rise and fall but	As a UK Pension Fund the Panel and Board consider that the Pension Fund should have a significant proportion of its assets denominated in Sterling, thereby removing the currency risk.

Risk description	Approach	Mitigation
denominated in any currency other than the functional currency of the Fund (GB pounds)	movements are difficult to forecast, and therefore that products that can smooth the impact of currency fluctuations do not offer value for money.	The Panel and Board keep their view of the long term nature of currency movements under review and will seek specialist advice if they believe that this might change or there is likely to be an event that might crystallise the effect of particular currency movements.
Credit risk – the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. This includes the risk of loss in the Stock Lending programme.	The Pension Fund recognises that all investment carries an element of risk, which underpins the importance that the Panel and Board place on their own knowledge and skills and seeking the appropriate professional advice.	The Panel and Board have set a diversified asset allocation which limits exposure to any particular investment. In addition to further reduce exposure to any particular investment the Fund has the following limits: • no more than 10% of each actively managed portfolio can be invested in any individual corporate holding • no more that 25% of the Fund can be invested in each managers' in-house investment vehicle, this limit does not apply to passively managed unitised life insurance policies • no more than 5% of the total value of all investments of fund money is to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007. Stock lending is managed on the Fund's behalf by its custodian JP Morgan. The custodian manages a collateralised stock lending programme, ensuring borrowers place collateral that exceeds the value of stock on loan that can make good any losses. Restrictions have been placed on the programme to ensure that the proportion of Fund assets that are available to be lent at any time will not exceed 25% of the total market value of Fund assets.

Refinancing risk – that the Pension Fund could be bound to replace on maturity a significant proportion of its financial instruments at a time of unfavourable interest rates.	The Pension Fund considers that investments that are time bound (such as bonds or closed-ended investment vehicles) have an important place in offering diversification from equities.	The Fund contracts with specialist external investment managers and as a general principle aims make their portfolios 'ever-green' so that income and maturing investments can be reinvested, allowing investment managers to build portfolios that do not have a concentration of investments with a particular maturity date.
Custody risk – losing economic rights to Fund assets, when held in custody or being traded.	The Fund has appointed a Global Custodian (currently JP Morgan) with a global custody network, to provide safe custody of its assets.	The Panel and Board and the Fund's officers regularly monitor the performance of the Fund's custodian and have the power to replace the provider should serious concerns exist.
Liability risk – that the Fund's liability are not accurately calculated resulting in the return target being too low and employer's contributions having to rise.	In calculating the Fund's liabilities its Actuary makes assumptions for the key factors, such as interest rates, pay and price inflation, life expectancy, changing retirement patterns and other demographic risks that will impact on the calculation of the Fund's liabilities.	The County Council as the Fund's Administering Authority will ensure that the Fund's Actuary investigates the main factors that determine the Fund's liabilities, such as interest rates, inflation, life expectancy and other demographics. The Fund's Actuary will report and agree with the Administering Authority any necessary changes to their assumptions and the resulting impact on the Fund's employers' contributions.
Environmental, social and governance (ESG) factors – that these factors reduce long-term returns.	Fund recognises that companies can enhance their long-term performance and increase their financial returns by adopting positive social, environmental and ethical principles.	The Fund's external investment managers have been instructed to exercise the Fund's responsibility to vote on company resolutions wherever possible. They have also been instructed to intervene in companies that are failing, thus jeopardising the Fund's interests, by voting or by contacting company management directly.
Illiquidity – that the Fund is unable to meet its immediate liabilities	Although the Fund does not have a strategic allocation to cash, a cash balance is maintained to meet liabilities as they fall due.	The Fund maintains a cashflow forecast to ensure that it can plan suitably in advance to ensure that it has sufficient cash available. The Fund's asset allocation is set to achieve a balance between liquid and illiquid investments.