

# INVESTMENT STRATEGY STATEMENT

## ESSEX PENSION FUND

MARCH 2017

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## **Introduction and background**

This is the Investment Strategy Statement (the “Statement”) of the Essex Pension Fund, which is administered by Essex County Council (the “Scheme Manager”) as required by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the “2016 Regulations”) in accordance with the guidance issued by Secretary of State.

Essex County Council is the Administering Authority for the Fund under the Regulations. In 2008, a Pension Board was established to exercise on behalf of Essex County Council all the powers and duties of the Council in relation to its functions as Administering Authority of the Essex Pension Fund, except where they have been specifically delegated by the Council to another Committee or an officer. Responsibility for setting and monitoring investment strategy has been specifically delegated to the Essex Pension Fund Investment Steering Committee (“ISC”). Responsibility for the day to day management of the Fund has been delegated to the Section 151 Officer (“s151O”) and the Director for Essex Pension Fund.

This statement has been prepared by the ISC having taken appropriate advice from the Fund’s Institutional Consultant, Hymans Robertson LPP, and its Independent Investment Adviser, Mark Stevens. The responsibilities of relevant parties are set out in appendix A.

The Statement is subject to periodic review at least every three years and from time to time on any material change in investment policy or other matters as required by law. The ISC has consulted on the content of this Statement with its stakeholders. The Statement is also subject to review by the Essex Pension Fund Advisory Board (PAB) which was established as the Local Pension Board for Essex in accordance with section 5 of the Public Service Pension Act 2013 and Part 3 of the LGPS Regulations 2013.

## **Investment strategy and the process for ensuring suitability of investments**

### **Fund Objective**

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, on a defined benefits basis.

The funding objective adopted for the Essex Pension Fund is to ensure that the assets of the Pension Fund, when taken in conjunction with future contributions, are sufficient to ensure that all future pension and retirement benefits will be fully covered by the Fund’s assets when they fall due.

This primary objective has been converted to a number of funding objectives, as set out in the Fund’s Funding Strategy Statement (FSS). The purpose of the FSS is:

- to establish a clear and transparent fund-specific strategy which will identify how employers’ pension liabilities are best met going forward;
- to support the desirability of maintaining as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

The funding position will be reviewed by the Essex Pension Fund Strategy Board (PSB) at each triennial actuarial valuation, with interim reviews occurring in the years between triennial valuations.

## **Funding Level**

The funding level of the Pension Fund is the value of the Fund's assets expressed as a percentage of the Fund's liabilities at the most recent actuarial valuation of the Fund. The funding level at March 2016 was 89%. The Funding Strategy provides for the Fund to return to a fully funded position over a period of 15 years. In accordance with the Funding Strategy Statement, the PSB determined the rate of contributions payable by each of the employers in the Fund for the three years starting 1 April 2017.

## **Investment Beliefs**

The ISC has adopted 4 core investment beliefs covering the following areas:

- Long Term Approach;
- Diversification;
- Benchmarks; and
- Active vs Passive Management.

Details are set out in appendix B.

## **Investment Strategy**

The Fund is maturing and analysis has been undertaken to forecast when new contributions (employees and employers including deficit) are not enough to meet all benefit payments falling due. This is normal for a pension scheme and reflects the purpose of the Fund (accumulate monies and then pay it out in benefits).

In order to meet the short to medium term cashflow requirements, the Investment Steering Committee at its 23 February 2015 meeting agreed to realise income from L&G's UK assets and Aviva's property portfolio.

Realised income may be held in cash short term in order to meet a proportion of benefit payments.

The initial requirements are small (c. 0.5% of total Fund assets) and is expected to be more than met by the income on assets. There should be no need to disinvest the capital value of any asset. The time at which the sale of assets will become a requirement will be subject to periodic review.

The Fund is therefore still in a position to target a predominantly growth-based strategy, with the aim of maximising asset value in the long term within agreed risk levels, which takes into account liquidity requirements.

There are varying levels of diversification between different asset classes to ensure that the value of the Pension Fund when taken in conjunction with future contributions is sufficient to ensure that all future pension and retirements benefits will be fully covered by the Fund's assets when they fall due, whilst managing the Fund within the ISC's risk appetite.

## **Asset Allocation**

The Fund has an 87% allocation to 'growth' (equities and alternatives) assets in order to meet the long term funding assumptions set out in the 2016 actuarial valuation.

The Fund's investments are allocated across a range of asset classes. The largest allocation is to equities which also accounts for the majority of the investment risk taken by the Fund. Over the long term, equities are expected to outperform other liquid asset classes, particularly bonds. Allocation to asset classes other than equities and bonds, allows the Fund to gain exposure to other forms of return which can help to reduce the overall volatility of the portfolio. These assets are in the main negatively correlated to equities and are expected to generate returns broadly similar over the long term and so allocation to these can maintain the expected return and assist in the management of volatility.

The 13% allocation to bonds is designed to manage overall levels of funding volatility within agreed levels.

### **Investment Allocation**

The Committee has translated its objectives into a suitable strategic asset allocation benchmark and structure for the Fund (set out in appendix C), taking into account both the liability structure and the objectives set out above. The Fund benchmark is consistent with the 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 Committee monitors investment strategy relative to the agreed asset allocation benchmark. In addition to on-going monitoring, the investment strategy is formally reviewed every six months at Committee meetings set aside for that purpose. Furthermore, specific consideration is given to investment strategy in the light of information arising from each triennial actuarial valuation.

### **Investment managers**

The Committee has appointed a number of active and passive investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, 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.

The managers appointed, and the mandates they manage, are detailed in appendix C. Appendix D details the objectives and investment rationale of the mandates.

### **Types of investment to be held**

The investment managers are required to comply with LGPS investment regulations. The Fund may invest in quoted and unquoted securities of UK and overseas markets, including equities, fixed interest and index linked bonds, cash, property, commodities, infrastructure, timber and loans either directly, through pooled funds or via partnership agreements.

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 Committee considers all of these classes of investment to be suitable in the circumstances of the Fund.

### **Currency hedging**

The Fund, to reduce the volatility associated with fluctuating currency rates (currency risk), has put in place a passive currency programme which is managed by Legal and General Investment Management. The Fund hedges 50% of its major overseas currency exposure within the equity portfolio.

Investment Managers have discretion to utilise hedges for risk management purposes.

## **Risk measurement and management**

### **Risk**

The Fund is exposed to a number of risks which pose a threat to the Fund meeting its objectives. These risks are set out and monitored as part of a formal risk register. An extract of the risk register relating to funding and investment is included in Appendix E. However, in summary, the principal risks affecting the Fund (including their reference code within the risk register) are:

#### ***Funding risks:***

- Financial mismatch – F1. The risk that Fund assets fail to grow in line with the developing cost of meeting Fund liabilities. F8. The risk that unexpected inflation increases the pension and benefit payments and the Fund assets do not grow fast enough to meet the increased cost.
- Changing demographics – F4. The risk that longevity improves and other demographic factors change increasing the cost of Fund benefits.
- Systemic risk - I2 & F3. The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting Fund liabilities.

#### ***Asset risks:***

- Concentration – I1 & I2. The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity – I11. The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Manager underperformance – I6. The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

#### ***Other provider risks – I13:***

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the ISC takes professional advice and considers the appointment of specialist transition managers.
- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.

#### ***Mitigations:***

The approach the ISC adopts to managing these risks is also addressed in Appendix E. However, in general terms, the risks are managed via a combination of:

- The appointment of professional advisers to assist the ISC in managing these risks;

- Agreed processes and guidelines for consideration and monitoring of the investments;
- Specific limits on individual investments;
- Ensuring the expected return from the investment strategy is consistent with the assumptions made by the Actuary in valuing the Fund;
- Assessments of the levels of risk taken by the Fund;
- Diversification across asset classes and managers; and
- Regular review and monitoring.

Full descriptions of these risks, including the mitigating actions taken by the ISC, are set out in appendix E.

### **Expected return on investments**

Over the long term, the overall level of investment return is expected to exceed the rate of return assumed by the Actuary in valuing the Fund and setting funding requirements.

### **Realisation of investments**

The majority of assets held within the Fund may be realised quickly if required. The Committee monitors both the level of liquid assets and the liquidity requirements of the Fund.

## **Asset pooling**

### **Overview**

The Fund is one of eleven participating Fund's in the ACCESS Pool (A Collaboration of Central, Eastern & Southern Shires) along with Cambridgeshire, East Sussex, Hampshire, Hertfordshire, Isle of Wight, Kent, Norfolk, Northamptonshire, Suffolk and West Sussex.

All eleven funds are committed to collaboratively working together to meet the government's criteria for pooling and have signed a Memorandum of Understanding to underpin their partnership.

The proposed structure and basis on which the ACCESS Pool will operate in order to meet the Government's criteria was set out in the July 2016 submission to Government. A copy of the submission is available on the ACCESS website at [www.accesspool.org](http://www.accesspool.org)

The participating authorities have a clear set of objectives and principles that will drive decision-making and help shape the design of the Pool. These underpin the design of the project plan that the ACCESS Funds are working towards.

The first arrangements to be brought under the ACCESS structure will be the passively managed assets. Arrangements are due to be put in place over the course of 2017.

### **Assets to be invested inside the Pool**

The Fund's intention is to invest its assets through the ACCESS Pool as and when suitable Pool investment solutions become available. An indicative timetable for investing through the Pool was set out in the July 2016 submission to Government. The key criteria for assessment of Pool solutions will be as follows:

- 1 That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund
- 2 That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

The Fund is monitoring developments with a view to transitioning liquid assets across to the Pool as and when suitable sub-funds to meet the Fund’s investment strategy requirements are in place.

Any assets that are not currently invested in the ACCESS Pool will be subject to review at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money.

The Essex Pension Fund is working towards the expectation that over time all investments will be pooled with the exception of direct property and operational cash. The table below sets out the rationale.

#### Assets to be invested outside the Pool

<b>Asset Class</b>	<b>Manager</b>	<b>Strategic Allocation %</b>	<b>Reason for not investing in the ACCESS Pool</b>
Direct Property	Aviva Investors	Up to 12%	<ul style="list-style-type: none"> <li>• Investment manager skill is a major determinant of returns. The availability of quality investment managers for a large mandate is untested.</li> <li>• The portfolio has been built to specific risk and return requirements</li> <li>• Portfolio designed to account for target holding sizes, to reflect the total portfolio size and achieve the required level of diversification</li> <li>• Moving holdings to part of a bigger direct portfolio would have significant cost implications such as Stamp Duty Land Tax (SDLT)</li> <li>• To reshape the portfolio to meet new objectives would be inconsistent with the value for money criteria</li> <li>• Project Pool analysis showed that increasing direct mandate size does not result in incremental cost savings</li> </ul>
Operational Cash	In-house	n/a	A reasonable level of operational cash will be required to maintain efficient administration of scheme. This will be held in house as ECC will need to manage cashflow to meet statutory liabilities, including monthly pension payroll payments.

This will be reviewed periodically by the ISC.

## **Environmental, Social & Governance Considerations**

### **Fiduciary duty**

The fundamental responsibility of the Fund is to ensure that it has adequate monies available to pay pensions as they fall due. This objective must be achieved in a cost effective way for members, employers and the taxpayer. Moreover, in reaching decisions, the Fund must comply with its fiduciary responsibilities.

### **Policy**

The ISC does not place restrictions on investment managers in choosing investments except in limiting the size of single investments. The ISC expects investment managers to place their primary consideration on financially material factors when selecting investments for inclusion in the portfolio, including any ESG factors considered to be financially material. An assessment of appropriate ESG capability is made before the manager is appointed.

However, the ISC will allow investment managers to consider non-financially material factors in selecting investments providing that such decisions are not expected to be financially detrimental to the Fund (either in terms of expected return or risk) or that the investment could represent significant opportunity cost if not held.

In general the ISC expects the selection of stocks based on a significant degree of non-financial reasons to be extremely rare and reserves the right to intervene on a case by case basis. Intervention is likely to be extremely rare as companies are aware of the increasing sensitivity of investors.

The ISC has determined that restricting investment may be of financial detriment to the Fund depending on price and outlook. Hence pursuing divestment goes against the Committee's fiduciary duty and responsibilities to maximise returns and manage costs for participating employers who ultimately bear the investment risk should a shortfall arise.

### **Exercise of voting rights**

The Fund has instructed its Fund Managers to vote in accordance with their in house policies and practices.

The Fund fully supports the UK Stewardship Code and requires those of its investment managers who hold shares on its behalf to comply with it or to provide the ISC with an explanation of why it is not appropriate to do so, in the exercise of the mandate that they have been given, and how they will instead achieve and demonstrate the same level of responsible share ownership.

The Fund's equity investment managers are signatories to the UK Stewardship Code and have all gained a Tier 1 status (demonstrating a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary).

### **Engagement**

The Fund expects its investment managers to take account of social, environmental and ethical considerations in the selection, retention and realisation of investments as an integral part of the normal investment research and analysis process. This is insofar as these matters are regarded as impacting on the current and future valuations of individual investments. The Fund believes taking account of such considerations forms part of the investment managers' normal fiduciary duty.

Instead of divesting, the ISC believes that they will have greater influence on the future direction of companies if they remain invested. Overall engagement activities are viewed by the Committee as a key element of the broader approach to responsible investment. Remaining invested provides the Fund with a voice on how companies are generating their revenues and how they will change in the future.

The Fund is a long term investor and therefore has an interest in the long term direction and success of the companies in which it invests. Divestment reduces the Fund's ability to influence how big companies change in the future.

### **Ongoing Monitoring**

The Committee actively monitors the Fund's investment managers' approaches. As part of this regular manager monitoring, the ISC will challenge their managers on how they consider and manage all financial risks faced by their investments, including those that arise from ESG considerations. The Committee also strives to improve and develop their knowledge and understanding on how ESG factors will impact the Fund's investments in the future.

### **Stock Lending**

The policy on stock lending (below) reflects the nature of the mandates awarded to investment managers by the ISC, which include both pooled and segregated mandates:

#### **Segregated Investments**

The Fund does not participate in stock lending schemes nor allow its stock to be lent.

#### **Pooled Investments**

In regard to the Fund's pooled investments, where the Fund is buying units in a pooled vehicle, stock lending is outside the control of the Fund and undertaken at the discretion of the fund manager.

# Appendix A – Responsibilities

## ISC Responsibilities

- To approve and annually review the content of the ISS.
- To appoint and review investment managers, custodian and advisors.
- To assess the quality and performance of each investment manager annually in conjunction with investment advisers and Section 151 Officer.
- To set the investment parameters within which the investment managers can operate and review these annually.
- To monitor compliance of the investment arrangements with the ISS.
- To assess the risks assumed by the Fund at a global level as well as on a manager by manager basis.
- To approve and review the asset allocation benchmark for the Fund.
- To submit quarterly reports on its activities to the Essex Pension Fund Strategy Board.
- To approve and annually review the content of the Pension Fund Treasury Management Strategy

## Section 151 Officer ('S151O') Responsibilities

- To manage the Pension Fund including the power to seek professional advice and to devolve day-to-day handling of the Fund to professional advisers within the scope of the Pensions Regulations.
- To provide a training plan for the members of the ISC (and the Strategy and Advisory Boards).

## Custodian Responsibilities

- To safeguard all segregated assets (excluding direct property holdings, unitised holdings and cash held separately with either the Administering Authority or investment managers) within the Fund and ensure that all associated income is collected, including dividends and tax reclaims. Also to ensure that corporate actions affecting the securities are dealt with, including rights issues, bonus issues and acquisitions.
- To provide regular statements of transactions, corporate actions, income and asset valuations as required by the Administering Authority.
- To report to the ISC in person on the assets of the Fund if required.
- To inform the Fund of any areas of concern which arise in its dealings with investment managers.
- To report the performance of the Fund's assets

## External Advisers

### Hymans Robertson

- To provide advice to the Fund on investment strategy, asset allocation, benchmark selection and design, investment management structure, legislative changes impacting on the Fund and current emerging issues.
- To prepare and present a report, based on information supplied by the Fund's custodian, on the annual investment performance of the Fund.
- To carry out on behalf of the Fund, when required, the functions of manager selection and manager monitoring.
- To carry out asset/liability modelling studies when required.
- To provide expert commentary on the economy and investment market.
- To attend and advise at all meetings of the ISC and all meetings arranged between its officers, advisers and managers.
- To assist the ISC in its annual review of asset allocation, investment management structure, SIP and Funding Strategy Statement.

### Independent Investment Adviser

- To assist the officers of the Fund in the determination of agendas and papers for the meetings of the ISC.
- In consultation with the officers of the Fund, to identify investment issues of strategic importance to the Fund and arrange for their consideration by the ISC e.g. asset allocation, and investment, management structure.
- In conjunction with the officers of the Fund, to keep under review the individual investment managers and where necessary put forward proposals for their management, including where appropriate their dismissal.
- To assist the officers of the Fund, where requested, in manager searches and other Fund procurement exercises.
- To assist the ISC in keeping under review its statutory publications.
- When requested by the officers, to attend and participate in monitoring, reviewing and briefing meetings arranged with investment managers, limited partners etc.

### Audit Responsibilities

The Fund is subject to review by both the County Council's External Auditors (EY) and internally by Internal Audit.

The Pension Fund financial statements contained in the Council's Annual Statement of Accounts present fairly:

- the financial transactions of its Pension Fund during the year; and
- the amount and disposition of the Fund's assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year.

The External Auditor audits the Pension Fund financial statements and gives their opinion, including:

- whether they present fairly the financial position of the Pension Fund and its expenditure and income for the year in question; and
- whether they have been prepared properly in accordance with relevant legislation and applicable accounting standards;

In carrying out their audit of the financial statements, auditors will have regard to the concept of materiality.

Additionally the Council must prepare a Pension Fund annual report which should contain the Pension Fund Account and Net Asset Statements with supporting notes and disclosures. External Audit will review the annual report as a whole and the accounts contained in it and then report:

- whether the accounts contained in the annual report are consistent with the financial statements on which the audit opinion was given; and
- that other information in the annual report is not inconsistent with the financial statements on which the audit opinion was given.

Internal Audit carry out a programme of work designed to reassure the S151O that Fund investment systems and records are properly controlled to safeguard the Fund's assets.

## Appendix B - Core Investment Beliefs

### Long term approach

#### Local authority (LA) funds take a long term view of investment strategy

This is largely based on covenant. Unlike the private sector, the covenant underlying the Fund is effectively gilt-edged. This means that short term volatility of returns can be acceptable in the pursuit of long term gain. Whilst there is a need to consider stability of contributions, at current maturity levels and with deficits spread over 20 years, it is largely the future service rate which is expected to drive instability. One of the best ways to avoid this is to build in margins over the long term. More recently, the ISC has noted the increasing maturity of the Fund and potential change in cashflow position on the horizon. It is therefore also taking this into consideration in decision making.

#### Over the long term, equities are expected to outperform other liquid asset classes, particularly bonds

Given the above, there is a preference for a significant allocation to equities in the Fund as over the long-term as they are expected (but not guaranteed) to outperform other asset classes.

#### Allocations to asset classes other than equities and bonds expose the Fund to other forms of risk premium

Investors with a long term investment horizon and little need for immediate liquidity can use this to their benefit as it offers the ability to capture the illiquidity premium on many asset classes, such as private equity and infrastructure.

### Diversification

#### Diversification into alternative asset classes (including property) is also expected to reduce overall volatility of the Fund's funding level

Given that the returns from different asset classes are expected to be delivered in different cycles (i.e. not be directly correlated with equity returns), the use of alternative assets can reduce overall volatility in the delivery of Fund returns without leading to a significant reduction in overall expected return, therefore increasing efficiency.

#### In the context of LA funds (open, long duration, not maturing quickly and with high equity content), an allocation to bonds does not offer a match to liabilities, but additional diversification.

Where bonds are not used for liability matching purposes, an allocation to these assets can be beneficial from an overall risk/return perspective improving the overall efficiency of the Fund. The corollary to this is that bond benchmarks do not necessarily have to reflect the nature and duration of the liabilities (see benchmark section below), but should be set to provide managers with the sufficient scope to add value.

#### The overweight to UK equities in most UK pension funds is historic and loosely based on currency exposures, rather than a preference for the UK market

Although historically the UK may have benefited from better corporate governance, and therefore a higher return, increasingly the rest of the world is catching up and UK equities are not expected to outperform overseas equities over the long term. Given the concerns over market concentration in the UK market and an increased opportunity set overseas a move towards increased overseas allocation relative to the UK seems appropriate. Concerns about currency risk can be addressed by a separate currency hedging programme.

## Benchmarks

### **Where appropriate, benchmarks should represent the full opportunity set.**

For example, for a global equity mandate, a market capitalisation (“market cap”) weighted benchmark reflects a passive allocation to the market (analogous to investing in a passive equity mandate and investing in each stock according to its size). It therefore reflects the investable universe of stocks available and represents the starting point for an equity benchmark.

### **To some extent market cap weighted indices reflect past winners, so should be treated with caution**

The regional exposures in the World Index are a function of the relative market cap of the regional stock markets. In turn, these are a function of the size of the economy as a whole and how well companies have performed in that economy. One measure of the size of the economy could be its overall contribution to global GDP. However, as has been seen in the UK, many companies in the market have little exposure to the domestic economy and, again, this should not be adhered to too slavishly. At the total fund level a fixed weights regional benchmark is therefore preferred in order to maintain an appropriate level of diversification across markets. This is particularly the case when the allocations are maintained by a passive “swing” manager.

### **Emerging market economies may be expected to outperform over the long term as the economy develops and the risk premium falls**

As emerging markets develop both politically and economically, become more robust and less dependent on the fortunes of a small number of developed economies (such as the US), the risk of investing in these countries should decrease. The return demanded by investors for investing in these ‘riskier’ countries will therefore fall reflecting the increased security. This reduction in required return would tend to lead to a systematic increase in stock prices. As a result, a strategic allocation to emerging markets of at least the market cap weight if not slightly above is favoured.

### **Bond benchmarks do not need to reflect the nature and duration of the liabilities**

As discussed in the diversification section above, if bonds are not held for liability matching purposes, benchmarks should be set in order to maximise the scope for adding value.

## Active versus passive management

### **Passive management is appropriate for obtaining a low cost allocation to efficient markets**

Where markets offer little scope for adding value through active management (such as individual allocations to UK equities, US equities and gilts) passive management is preferred as a low cost way of accessing the market. This does not include emerging markets where the risk inherent in the market (although improving as stated above) and inefficiency of the market lends itself to active management.

### **Active management is appropriate where a market is relatively inefficient offering opportunities for active managers to add value**

Where markets offer substantial scope for added value active management would seem appropriate as a way of increasing overall expected return (after fees) without significantly increasing the overall level of volatility in the funding level.

### **Constraints on active managers reduce their ability to add value**

Active managers should not be unnecessarily constrained (within appropriate risk limits) and should be given the maximum scope to implement their active views. There is therefore a preference for unconstrained mandates e.g. unconstrained global equity mandates and unconstrained bond mandates such as M&G's LIBOR plus approach. This also suggests that, within reason, managers' requests for additional scope should be acceded to.

### **A degree of diversification of managers improves the efficiency of the overall structure (i.e. improves the expected return per unit of risk)**

Active manager performance is expected to be cyclical and therefore by appointing a number of managers the delivery of returns is expected to be less volatile. However, too much diversification can lead to expensive index tracking.

### **A rigorous approach to active manager selection improves the chance of appointing an active manager who will add value over the long-term**

An active manager must outperform their benchmark after fees to add value. The selection of an active manager must assess more than just past performance and look into the infrastructure supporting the performance including; business and ownership, philosophy and process, people, risk controls and fees.

### **The Fund does not have the governance structure in place to take tactical views and market timing is very difficult**

Both timing investments into the market and taking tactical views are very difficult given the governance structure in place and the time taken to agree and implement decisions. Where possible these decisions are left to professional investment managers who are closer to the market and can implement tactical views in a more timely fashion. This highlights the importance of not unnecessarily constraining active managers and providing them with appropriate scope.

### **The assessment of active management performance should be taken with a long-term view and take account of the market environment in which returns are delivered**

Active management is cyclical and periods of underperformance from investment managers should be expected so the structure should be such that when the market cycle is unfavourable for some managers it is favourable for others and vice versa. This is expected to deliver added value over the long-term whilst smoothing the overall performance at the total Fund level. Churning of managers leads to additional costs; however, where the ISC no longer views an investment manager's prospects as positive over the long-term, action should be implemented as soon as possible due to the potential downside risk.

## Appendix C – Fund Strategy and structure

### Summary

Equities			Bonds			Alternatives		
	Manager	Target %		Manager	Target %		Manager	Target %
<b>UK</b>	LGIM	5.0	<b>Index-linked gilts</b>	LGIM	2.0	<b>Property</b>	Aviva	12.0
<b>Regional</b>	LGIM	15.0		GSAM	5.5	<b>Private equity</b>	Hamilton Lane	4.0
<b>Global</b>	Marathon	35.0	<b>Active Cash plus</b>	M&G	5.5	<b>Infrastructure</b>	IFM Investors	6.0
	M&G				JPMorgan			
	Longview				M&G			
	Baillie Gifford				Partners Group			
	LGIM RAFI							
<b>Emerging</b>	Stewart Investors	5.0				<b>Timber</b>	Stafford	2.0
<b>Total</b>		<b>60.0</b>	<b>Total</b>		<b>13.0</b>	<b>Loans</b>	M&G	0.5
						<b>Illiquid debt</b>	Alcentra	2.5
						<b>Total</b>		<b>27.0</b>

The Fund also hedges 50% of the currency risk arising from its investment in overseas equities via a currency overlay mandate with Legal and General.

	Swing			Equity						Bonds				Alternatives			
	Effective Benchmark	L&G Equity	L&G Bonds	L&G RAFI	Longview	Marathon	Baillie Gifford LTGG	M&G	Stewart	GSAM	M&G	Property	Timber	Direct lending	Infrastructure	Financing	Private Equity
<b>Fund Weighting</b>	<b>100.0</b>	<b>20.0</b>	<b>2.0</b>	<b>7.0</b>	<b>7.0</b>	<b>7.0</b>	<b>7.0</b>	<b>7.0</b>	<b>5.0</b>	<b>5.5</b>	<b>5.5</b>	<b>12.0</b>	<b>2.0</b>	<b>2.5</b>	<b>6.0</b>	<b>0.5</b>	<b>4.0</b>
UK equities (All Cap)	3.4	16.8															
UK equities (Mid/Small C	1.7	8.6															
Global equities	35.0			100.0	100.0	100.0	100.0	100.0									
North America	6.5	32.7															
Europe	4.8	24.1															
Japan	2.3	11.3															
Pacific ex-Japan	1.3	6.5															
Emerging markets	5.0							100.0									
<b>Total Equities</b>	<b>60.0</b>	<b>100.0</b>		<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>								
UK index linked	2.0		100.0														
UK Gilts																	
UK Corps																	
Libor+	11.0									100.0	100.0						
<b>Total bonds</b>	<b>13.0</b>		<b>100.0</b>							<b>100.0</b>	<b>100.0</b>						
Infrastructure	6.0														100.0		
Timber	2.0												100.0				
Private equity	4.0																100.0
Property	12.0											100.0					
Financing	0.5															100.0	
Direct Lending	2.5													100.0			
<b>Total alternatives</b>	<b>27.0</b>											<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

## Appendix D – Fund Manager Mandate Objectives

### Legal and General Investment Management

#### Passive Mandate (Regional Indexes) - 22% of the Fund

##### Investment Objective

The objective is to match the Benchmark gross of fees over rolling three year periods. The Benchmark is the average of the respective FTSE indices for each of the asset classes and markets in which the mandate is invested and weighted in accordance to the proportions in the mandate's asset allocation shown below:

##### Investment Allocations:

The asset allocations are as below:

<b>Asset Class</b>	<b>Target Allocation</b>	<b>Range</b>
<u>Equities</u>	%	%
UK Equities Index	25.4	23.4 - 27.4
North America Equity Index	32.7	30.7 - 34.7
Europe Equity Index	24.1	22.1 - 26.1
Japan Equity Index	11.3	9.8 – 12.8
Asia Pacific ex Japan Index	6.5	5.75 – 7.25
<b>Total equities</b>	<hr/> 100	
<u>Bonds</u>		
UK Index-linked (Over 5 Year Index-linked Gilts Index)	100	
<b>Total bonds</b>	<hr/> 100	

##### Investment Restrictions

Legal and General may not invest in unlisted securities. The manager may invest up to 100% of its mandate in pooled life funds.

### Legal and General Investment Management

#### Global Equity Passive Mandate (RAFI) - 7% of the Fund

##### Investment Objective

The objective is to match the Benchmark gross of fees over rolling three year periods. The benchmark being the L&G FTSE RAFI AW 3000.

### Legal and General Investment Management

#### Passive Currency Mandate

The mandate requires Legal & General to hedge 50% of the estimated value of the exposure to certain overseas equity markets. The hedge is adjusted on a quarterly basis with the new positions calculated using estimated values as at close of business two days before the quarter end.

## **Baillie Gifford**

### Global Equity Mandate – 7% of the Fund

#### **Investment Objective**

The objective is to seek to outperform the MSCI AC World Index by 3%, gross of fees, per annum over rolling 5 year periods.

#### **Investment Restrictions**

The investment restrictions on the manager's discretion in the management of the mandate are set out in full in the Investment Management agreement. The main restrictions are set out below:

The manager aims to ensure adequate diversification, holdings between 30 and 60 stocks. No more than 10% of the portfolio is held in any individual stock and a minimum of six sectors are represented at all times

The Manager takes a pragmatic approach to risk the greatest risk is an absolute loss of capital, therefore, on an ongoing basis the manager reviews themes and stock concentrations in the portfolio as well as how stocks might perform in different scenarios, and levels of correlation between them

Consistent with their long-term investment philosophy the portfolio turnover is low.

## **Longview Partners**

### Global Equity Mandate – 7% of the Fund

#### **Investment Objective**

The objective is to seek to outperform the MSCI AC World Index by 3%, gross of fees, per annum over rolling 3 year periods.

#### **Investment Restrictions**

The investment restrictions on the manager's discretion in the management of the mandate are set out in full in the Investment Management agreement. The main restrictions are set out below:

The manager aims to ensure adequate diversification, holdings between 30 and 50 stocks. No more than 7% of the portfolio is held in any individual stock and a range of sectors will be represented at all times

No restrictions are placed on companies domiciled in a country included within the benchmark. A maximum of 20% of the portfolio at time of purchase may be invested in companies domiciled in countries not included within the benchmark

Longview may not lend any stock, fund, share or asset forming part of the portfolio or borrow cash and/or securities for leveraging of the Portfolio.

## **Marathon Asset Management**

### Global Equity Mandate – 7% of the Fund

#### Investment Objective

The objective is to seek to outperform the MSCI AC World Index by 3%, gross of fees, per annum over rolling 3 year periods.

#### Investment Restrictions

The investment restrictions on the manager's discretion in the management of the mandate are set out in full in the Investment Management agreement. The main restrictions are set out below:

Investment will be permitted in ordinary share, preference shares, convertible bonds, warrants and cash

The Fund will be diversified, containing a minimum of 100 securities

The Fund will not hold more than 3% of the issued share capital of any one security

The maximum percentage of the Fund which may be invested in any one share is 10% of the Fund or its benchmark weighting whichever is the greater.

Cash and Cash equivalent securities will not exceed 10% of the Fund's value except for short periods when rebalancing is taking place

## **M&G Investments**

### Global Equity Mandate – 7% of the Fund

#### Investment Objective

The objective is to seek to outperform the MSCI AC World Index by 3%, gross of fees, per annum over rolling 3 year periods.

The fund aims to deliver a dividend yield above the market average, by investing mainly in a range of global equities. The fund aims to grow distributions over the long term whilst also maximising total return (the combination of income and growth of capital).

#### Investment Restrictions

There are no investment restrictions placed on the manager as this investment is in M&G Global Dividend pooled fund. The Fund itself has built in restrictions, but offers flexibility to allocate across sectors and geographies without constraints.

## **Stewart Investors**

### Global Equity Mandate – 5% of the Fund

#### Investment Objective

The objective is to seek to outperform the MSCI EM Index by 4%, gross of fees, per annum over rolling 3 year periods.

### Investment Restrictions

The investment restrictions on the manager's discretion in the management of the mandate are set out in full in the Investment Management agreement. The main restrictions are set out below:

Investment will be permitted in ordinary share, preference shares, convertible bonds, warrants and cash

The Fund will be diversified, containing a minimum of 30 securities

The Fund will not hold more than 3% of the issued share capital of any one security

Cash and Cash equivalent securities will not exceed 10% of the Fund's value except for short periods when rebalancing is taking place

### Aviva

#### Property Mandate – 12% of the Fund

### Investment Objective

The objective is to seek to outperform the Benchmark by 1% per annum gross of fees over rolling three year periods. The Benchmark is the weighted average of the IPD PFI All Balanced Property Funds Index.

This objective is to be achieved by investing in a combination of direct and indirect property portfolios.

### Investment Restrictions

The Fund is managed on a discretionary basis and the manager shall transition the Fund to comply with the target allocation and permitted ranges as below.

#### Asset allocation and control ranges

Aviva will invest in a range of property investments, subject to the following constraints.

<b>Asset Allocation</b>	<b>Target Allocation</b>	<b>Range</b>
	%	%
Direct Property	75	50 - 100
Indirect Property	25	25 - 50
Cash*	0	0 - 20
<b>Total</b>	<hr/> 100	

\*In times of severe market stress there is flexibility to hold up to a maximum of 20% in cash

## **M & G**

Fixed Income Mandate – 5.5% of the Fund

### **Investment Objective**

The Fund seeks a total return of 1 month Libor +2% net of fees p.a. over the medium term.

### **Investment Restrictions**

There are no specific investment restriction's placed on the manager as this investment is in M&G's Alpha Opportunities Fund which aims to take advantage of highly diversified opportunities in public and private credit markets, including but not limited to investment grade and high yield corporate bonds, leveraged loans, asset-backed, and mortgage backed securities.

## **Goldman Sachs Asset Management**

Fixed Income Mandate – 5.5% of the Fund

### **Investment Objective**

The Fund seeks a total return of 3 month Libor +2% gross of fees p.a. over the medium term.

### **Investment Restrictions**

There are no specific investment restriction's placed on the manager as this investment is in its STAR I Fund which aims to take advantage of highly diversified opportunities in public and private credit markets, including but not limited to investment grade and high yield corporate bonds, leveraged loans, asset-backed, and mortgage backed securities.

## **Hamilton Lane**

Private Equity Mandate - 4% of the Fund

### **Investment Objective**

The Fund seeks a total return of 3% - 5% p.a. above quoted equity markets.

### **Investment Restrictions**

Hamilton Lane has a global investment mandate in primary partnerships, secondary partnerships and co-investments within private equity. No restrictions have been placed on the fund other than prior approval will need to be sought if the manager wishes the Fund to co-invest.

## **Partners Group**

Infrastructure Mandate - 4% of the Fund

### **Investment Objective**

The Fund seeks an IRR of 8% to 10% p.a.

### **Investment Restrictions**

There are no specific restrictions placed on the manager as this is a pooled investment in Partner's Group Global Infrastructure and Partner's Direct fund which seeks investment opportunities in direct, secondary and primary infrastructure markets.

### **M&G Infracapital\***

Infrastructure Mandate - 2% of the Fund

At present this investment is being wound up and capital is being returned.

#### **Investment Objective**

The Fund seeks a total return of CPI + 4% p.a. and IRR of 10% -15% p.a.

#### **Investment Restrictions**

There are no specific restrictions placed on the manager as this Infracapital is a pooled investment in which seeks investment opportunities in direct, secondary and primary infrastructure space.

### **IFM Investors\***

Infrastructure Mandate - 1% of the Fund

#### **Investment Objective**

The Fund seeks an expected return of 8% to 12% p.a. net.

#### **Investment Restrictions**

There are no specific restrictions placed on the manager as this is a pooled open ended investment in IFM Investors Global Infrastructure Fund which seeks investment opportunities in global core infrastructure assets over a broad sector.

### **JPMorgan\***

Infrastructure Mandate - 1% of the Fund

#### **Investment Objective**

The Fund seeks an expected return of 8% to 12% p.a. net.

#### **Investment Restrictions**

There are no specific restrictions placed on the manager as this is a pooled open ended investment in JPMorgan IFF fund which seeks investment opportunities in OECD regions of core and core plus infrastructure assets concentrating on transportation regulated utilities and contracted power assets.

### **Stafford Timberland**

Timberland Mandate - 2% of the Fund

#### **Investment Objective**

The Fund seeks an IRR of 10% p.a.

#### **Investment Restrictions**

There are no specific restrictions placed on the manager as this is a pooled investment in its Stafford International Timberland VI Fund and its Stafford International Timberland VII Fund (no2) which seeks investment opportunities in direct, secondary and primary timberland.

## **Alcentra Limited**

Illiquid Debt Mandate – 2.5% of the Fund

### **Investment Objective**

The Fund invests both indirectly and directly and seeks 7% -9% net returns and 10% -12% net returns respectively

### **Investment Restrictions**

There are no specific restrictions placed on the manager as this is a pooled investment in which seeks both direct and indirect investment opportunities in the illiquid debt space.

## **M&G**

Financing Mandate – 0.5% of the Fund

### **Investment Objective**

The Fund seeks a return of LIBOR +4-6% (net of fees) p.a.

### **Investment Restrictions**

There are no specific restrictions placed on the manager as this is a pooled investment in its Stafford International Timberland VI Fund and its Stafford International Timberland VII Fund (no2) which seeks investment opportunities in direct, secondary and primary timberland.

\*The allocation of 1% each to IFM Investors and JPMorgan will replace the 2% allocation to M&G Infracapital when the investment is wound up during to 2017/2018.

## Appendix E – Investment and funding risk register: key

			Impact (Negative)			
			Minor	Moderate	Major	Critical
			1	2	3	4
Probability	4	Almost Certain	Medium (4)	High (8)	VeryHigh (12)	Very High (16)
	3	Likely	Medium (3)	High (6)	High (9)	Very High (12)
	2	Possible	Low (2)	Medium (4)	High (6)	High (8)
	1	Unlikely	Low (1)	Low (2)	Medium (3)	Medium (4)

Essex Pension Fund Risk Register

Risk Area: Essex Pension Fund Date: 01/03/2017

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Investment Risks</b>										
Investments	To maximise the returns from investments within reasonable risk parameters	I1	If investment return is below that assumed by the Actuary in funding the plan this could lead to an increasing deficit and additional contribution requirements. The larger the level of mismatch between assets and liabilities the bigger this risk.	4	3	12	Diversified portfolio; Annual Strategy Review; Asset Liability Study, extended recovery periods to smooth contribution increases.	3	3	9
Investments	To maximise the returns from investments within reasonable risk parameters	I2	Inefficiencies within the portfolio can result in unintended risks	3	3	9	Diversified portfolio; Annual Strategy Review; Quantification of individual components of financial risks, Hedging of some risks, Obtain expert advice	2	1	2
Investments	To maximise the returns from investments within reasonable risk parameters	I3	If investment returns are below peer group funds, or risk levels are excessive relative to peer group, this could lead to reputational damage for the Fund or member/admitted body dissatisfaction.	3	3	9	Regular monitoring; Annual Strategy Review; Targeting most efficient portfolio	2	2	4
Investments	To maximise the returns from investments within reasonable risk parameters	I4	Risk of missing opportunities to maximise returns	2	3	6	Regular monitoring; more than one investment adviser; dialogue with existing managers to encourage new ideas; peer group dialogue	2	2	4
Investments	To maximise the returns from investments within reasonable risk parameters	I5	If investment strategy is inconsistent with Funding Plan then it can lead to employers paying the incorrect contribution rate	4	3	12	Triennial Reviews linked with Funding Strategy & Investment Strategy. Asset Liability Study; SIP; Interim Reviews; co-ordination between actuary and investment consultant. A specific scorecard measure on this matter is in place.	2	1	2

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Investment Risks</b>										
Investments	To maximise the returns from investments within reasonable risk parameters	16	Fund managers underperform their benchmarks	2	2	4	Manager selection process and due diligence; manager monitoring across wide range of issues; diversified portfolio of managers; setting of appropriate benchmarks	2	1	2
Investments	To ensure the Fund is properly managed	17	Inappropriate or uninformed decisions e.g. due to lack of understanding / training	3	3	9	Training and experience of ISC members; monitoring of knowledge and understanding; an institutional investment adviser and an independent adviser have been appointed; training and experience of in house team; papers prepared in advance of decisions being made; Annual Strategy Review sets plan for year	1	2	2
Investments	To ensure the Fund is properly managed	18	Insufficient management information about the position of the Fund e.g. level of risk; amount of assets; performance of managers	2	3	6	Regular quarterly reporting on assets, performance and managers; Annual Strategy Review	1	1	1
Investments	To ensure the Fund is properly managed	19	Failure to take expert advice or risk of poor advice	2	3	6	Appointment of institutional investment consultant and an independent investment adviser, who regularly attend meetings	1	1	1
Investments	To ensure the Fund is properly managed	110	Delays in implementation of decisions reduces the effectiveness of the decision	2	3	6	In house team; use of passive manager to implement change; delegation of implementation to officers and advisers	1	2	2

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Investment Risks</b>										
Investments	To ensure the Fund is properly managed	I11	If liquidity is not managed correctly, assets may need to be sold at unattractive times or investment opportunities missed as cash is unavailable.	2	2	4	Limit on illiquid assets and level of diversification from equities and bonds; projection of expected cash flows. A specific scorecard measure is in place on this matter.	1	1	1
Investments	To ensure the Fund is properly managed	I12	Insufficient scrutiny of manager mandates and terms of business may lead to inappropriate fee levels or other costs.	2	3	6	Quarterly monitoring; review of fees versus peer group; selection criteria include fees and other costs	1	2	2
Investments	To ensure the Fund is properly managed	I13	Failure of manager or custodian	3	1	3	Quarterly monitoring; AAF0106 audit reports; investment consultant on-going research; diversification of manager mandates; diversification of custody via pooled funds	2	1	2
Investments	To ensure the Fund is properly managed	I14	Failure to react to major change in market / economic conditions	3	2	6	Quarterly monitoring, setting appropriate mandates for managers, appointment of investment consultant and independent advisers, review of market conditions at each meeting, regular engagement with investment managers	2	1	2

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
Investments	Ensure all significant Fund investment issues are communicated properly to all interested parties	I15	Inappropriate communication of risks involved in the pension fund and strategy adopted and actions taken by the ISC may lead to questions and challenge and unexpected increases in contributions	2	3	6	Resourcing of in house team; discussion forums and surgeries; statement of investment principles; funding strategy statement	1	2	2
Investments	To ensure the Fund is properly managed	I16	The implementation of MiFiD II (January 2018) leads to the Fund being categorised by some / all of its service providers as a 'retail client' - the result of which could reduce the range of sub asset classes in which the Fund is able to invest, and may even require divestment from the current portfolio.	4	3	12	1. Representations at national level aimed towards LGPS retaining professional client status. 2. Fund Officers working with Fund Managers & Investment Advisers aimed towards the Essex Fund retaining professional client status. Developments continue to be monitored.	4	2	8

Essex Pension Fund Risk Register

Risk Area: Essex Pension Fund Date: 01/03/2017

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Funding Risks</b>										
Funding	Within reasonable risk parameters, to achieve and then maintain assets equal to 100% of liabilities in the timescales determined by the Funding Strategy	F1	Investment markets perform below actuarial assumptions resulting in reduced assets, reduced solvency levels and increased employer contributions	4	2	8	Use of a diversified portfolio which is regularly monitored against targets and reallocated appropriately. At each triennial valuation assess funding position and progress made to full funding. Full annual interim reviews to enable consideration of the position. A specific scorecard measure is in place on this matter.	2	2	4
Funding	Within reasonable risk parameters, to achieve and then maintain assets equal to 100% of liabilities in the timescales determined by the Funding Strategy	F2	Markets move at variance with actuarial assumptions resulting in increases in deficits, reduced solvency levels and increased employer contributions	4	3	12	Annual interim reviews to enable consideration of the position and the continued appropriateness of the funding/investment strategies and to monitor the exposure to unrewarded risks.	3	3	9
Funding	Within reasonable risk parameters, to achieve and then maintain assets equal to 100% of liabilities in the timescales determined by the Funding Strategy	F3	Investment managers fail to achieve performance targets (i.e. ensure funding target assumptions are consistent with funding objectives) which reduces solvency levels and increases required in employers' contributions	3	3	9	Diversified investment structure and frequent monitoring against targets with potential for a change of managers where considered appropriate.	2	2	4
Funding	Within reasonable risk parameters, to achieve and then maintain assets equal to 100% of liabilities in the timescales determined by the Funding Strategy	F4	Mortality rates continue to improve, in excess of the allowances built into the evidence based actuarial assumptions, resulting in increased liabilities, reduced solvency levels and increased employer contributions	3	3	9	Monitoring of mortality experience factors being exhibited by the Fund members by Fund Actuary and consequent variation of the actuarial assumptions based on evidential analysis.	2	2	4

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Funding Risks</b>										
Funding	Within reasonable risk parameters, to achieve and then maintain assets equal to 100% of liabilities in the timescales determined by the Funding Strategy	F5	Frequency of early retirements increases to levels in excess of the actuarial assumptions adopted resulting in increases required in employers' contributions	3	3	9	Employers required to pay capital sums to fund costs for non-ill health cases. Regular monitoring of early retirement (including on the grounds of ill health) experience being exhibited by the Fund members by Fund Actuary and consequent variation of the actuarial assumptions based on evidential analysis. Ensure that employers are made aware of consequences of their decisions and that they are financially responsible.	2	2	4
Funding	To recognise when drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible	F6	Failure to apply and demonstrate fairness in the differentiated treatment of different fund employers by reference to their own circumstances and covenant	4	3	12	At each triennial actuarial valuation an analysis is carried out to assess covenant and affordability on a proportional basis. On-going dialogue with employers.	2	2	4
Funding	To recognise when drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible	F7	Mismatch in asset returns and liability movements result in increased employer contributions	4	3	12	Diversified investment structure and frequent monitoring against targets to adjust funding plans accordingly through the FSS. Employers are kept informed as appropriate.	3	2	6

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Funding Risks</b>										
Funding	To recognise when drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible	F8	Pay and consumer price inflation significantly different from actuarial assumptions resulting in increases required in employers' contributions	3	2	6	At each triennial actuarial valuation an analysis is carried to ensure that the assumptions adopted are appropriate and monitor actual experience. Discussions with employers over expected progression of pay in the short and long term.	2	2	4
Funding	To recognise when drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible	F9	Potential for significant increases in contributions to levels which are unaffordable. Ultimate risk is the possibility of the employers defaulting on their contributions	3	3	9	Risk profile analysis performed with a view on the strength of individual employer's covenant being formed when setting terms of admission agreement (including bonds) and in setting term of deficit recovery whilst attempting to keep employers' contributions as stable and affordable as possible. Pursue a policy of positive engagement with a view to strengthening employer covenants wherever possible.	2	2	4
Funding	To recognise when drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible	F10	Adverse changes to LGPS regulations resulting in increases required in employers' contributions or Fund cash flow requirements.	4	2	8	Ensuring that Fund concerns are considered by the Officers/Board as appropriate and raised in consultation process with decision makers lobbied. Employers and interested parties to be kept informed. Monitor potential impact for employers in conjunction with Actuary.	3	1	3

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Funding Risks</b>										
Funding	To recognise when drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible	F11	Adverse changes to other legislation, tax rules, etc. resulting in increases required in employers' contributions	3	2	6	Ensuring that Fund concerns are considered by the Officers/Board as appropriate and raised in consultation process with decision makers lobbied. Employers and interested parties to be kept informed. Monitor potential impact for employers in conjunction with Actuary.	3	1	3
Funding	To manage employers' liabilities effectively, having due consideration of each employer's strength of covenant, by the adoption of employer specific funding objectives	F12	Administering authority unaware of structural changes in an employer's membership, or not being advised of an employer closing to new entrants, meaning that the individual employer's contribution level becomes inappropriate requiring review and increase	3	3	9	Ensure that employers are reminded of their responsibilities, monitor and send reminders of employers' responsibilities re this where appropriate, investigate the adoption of an administration strategy to clarify employer responsibilities. Employer analysis work and officer dialogue with employers concerned (including guarantors as appropriate)	2	2	4
Funding	To manage employers' liabilities effectively, having due consideration of each employer's strength of covenant, by the adoption of employer specific funding objectives	F13	Not recognising opportunities from changing market, economic or other circumstances (e.g. de-risking or strengthening of covenant)	3	3	9	At each triennial valuation pursue a policy of positive engagement with a view to strengthening employer covenants wherever possible.	2	2	4
Funding	To manage employers' liabilities effectively, having due consideration of each employer's strength of covenant, by the adoption of employer specific funding objectives	F14	Adoption of either an inappropriately slow or rapid pace of funding in the specific circumstances for any particular employer	3	4	12	At each triennial actuarial valuation an analysis is carried out to assess covenant and affordability on a proportional basis. On-going dialogue with employers.	2	2	4

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Funding Risks</b>										
Funding	To manage employers' liabilities effectively, having due consideration of each employer's strength of covenant, by the adoption of employer specific funding objectives	F15	Failure to ensure appropriate transfer is paid to protect the solvency of the Fund and equivalent rights are acquired for transferring members in accordance with the regulations.	2	3	6	Follow the standardised approach to bulk transfers of liabilities as part of admission policy framework, complying with any statutory requirements and protecting the interests of the Fund's employers by measuring the solvency of the Fund and relevant employers before and after transfer.	2	1	2
Funding	To have consistency between the investment strategy and funding strategy	F16	Over or under cautious determination of employer funding requirements due to the impact of the investment strategy on funding	3	3	9	Measurement will look at expected return projections vs actuarial assumptions in order to test the continued appropriateness and consistency between the funding and investment strategy.	2	2	4
Funding	Maintain liquidity in order to meet projected net cash-flow outgoings	F17	Illiquidity of certain markets and asset classes and difficulty in realising investments and paying benefits as they fall due	3	3	9	Holding liquid assets and maintain positive cash flows. Reviews performed to monitor cash flow requirements	2	1	2

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Funding Risks</b>										
Funding	Maintain liquidity in order to meet projected net cash-flow outgoings	F18	Unanticipated onset of cash-flow negative position, potentially requiring ad hoc repositioning of assets	3	3	9	Holding liquid assets and maintain positive cash flows. Reviews performed to monitor cash flow requirements. In Spring 2015 the ISC agreed to divert a portion of UK equity dividend income (L&G) & property rental income (AVIVA) to supplement contribution income in order to meet pension benefit expenditure.	2	1	2
Funding	Minimise unrecoverable debt on termination of employer participation	F19	An employer ceasing to exist with insufficient funding, adequacy of bond or guarantee. In the absence of all of these, the shortfall will be attributed to the Fund as a whole with increases being required in all other employers' contributions	4	3	12	Assess the strength of individual employer's covenant and/or require a guarantee when setting terms of admission agreement (including bonds) and in setting term of deficit recovery. Annual monitoring of risk profiles and officer dialogue with employers concerned (including guarantors as appropriate) through employer analysis. Positive dialogue with employers with a view to strengthening employer covenants wherever possible. Same mitigations for both risks F19 & F20	3	2	6

Objectives Area at Risk	Objective at Risk	Risk Ref	Description of Risk of not Achieving the Objectives	Gross Impact	Gross Probability	Gross Risk score	Possible Actions	Residual Impact	Residual Probability	Residual Risk Score
<b>Funding Risks</b>										
Funding	Minimise unrecoverable debt on termination of employer participation	F20	Failure to monitor leading to inappropriate funding strategy and unrecovered debt on cessation of participation in the fund	4	3	12	Assess the strength of individual employer's covenant in conjunction with the Actuary and/or require a guarantee when setting terms of admission agreement (including bonds) and in setting term of deficit recovery. Annual monitoring of risk profiles and officer dialogue with employers concerned (including guarantors as appropriate) through employer analysis. Positive dialogue with employers with a view to strengthening employer covenants wherever possible	3	2	6
Funding	Maintain liquidity in order to meet projected net cash-flow outgoings	F21	Employee participation in the Essex LGPS reduces (possibly in response to changes in contribution rate / benefit structure or changes in patterns of service delivery)	4	3	12	Communications with both Employers and Employees over the benefits of the LGPS, both before and after any structural change. In July 2011, following discussion on liquidity and fund maturity, the ISC set a 27% limit on exposure to alternative assets.	3	2	6

## Appendix F – Statement of Compliance: the six Myners principles of good investment practice

Description of Principle	Essex Pension Fund's position	Future actions
<p><b>1. Effective decision making</b></p> <p>Administering Authorities should ensure that:</p> <ul style="list-style-type: none"> <li>Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation</li> </ul> <p>and</p> <ul style="list-style-type: none"> <li>Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.</li> </ul>	<p>Responsibility for approval and review of the investment strategy of the Essex Pension Fund has been delegated to the Investment Steering Committee (ISC). Every quarter, the ISC reports its activity to the Essex Pension Strategy Board (the Strategy Board), the body with overall responsibility for the Essex Pension Fund.</p> <p>The day to day running of the Fund has been delegated to the S1510. The ISC is supported by the S1510, the Director for Essex Pension Fund and other Fund officers.</p> <p>Institutional investment advice to the ISC and Fund officers is commissioned from Hymans Robertson. Furthermore Mark Stevens acts as an independent investment adviser.</p> <p>An on-going programme of training for Members of the ISC and Strategy Board is in place based on the CIPFA Knowledge &amp; Skills Framework. Launch of infoBOARD (an online document repository for ISC/ Strategy Board Members) in July 2013. Member training is also recorded and feeds into the scorecard on quarterly basis</p> <p>Fund officers hold relevant qualifications and maintain appropriate on-going professional development (CPD).</p> <p>The Essex Pension Fund is a member of the CIPFA Pensions Network.</p>	<p>On-going Member and Fund officer training.</p>

Description of Principle	Essex Pension Fund's position	Future actions
<p><b>2. Clear objectives</b></p> <p>An overall investment objective(s) should be set for the fund that takes account of the scheme liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be communicated to advisers and investment managers.</p>	<p>The Funding Strategy Statement (FSS) and Investment Strategy Statement (ISS) set out the Essex Pension Fund's primary funding objectives.</p> <p>Specific investment objectives are in place for each mandate in the portfolio, and these are regularly monitored by the ISC.</p> <p>The Strategy Board has also agreed a series of objectives across five areas: Governance, Investment, Funding, Administration &amp; Communications. Progress against objectives is monitored regularly by the Fund's scorecard. These objectives include:</p> <ul style="list-style-type: none"> <li>• Ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise</li> <li>• To maximise the returns from investments within reasonable risk parameters</li> <li>• To manage employers' liabilities effectively, having due consideration of each employer's strength of covenant, by the adoption of employer specific funding objectives</li> <li>• To recognise in drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible</li> <li>• Communicate in a friendly, expert and direct way to our stakeholders, treating all our stakeholders equally</li> </ul>	<p>Continual monitoring and review of objectives.</p>

Description of Principle	Essex Pension Fund's position	Future actions
<p><b>3. Risk &amp; liabilities</b></p> <ul style="list-style-type: none"> <li>• In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of their liabilities.</li> <li>• These include the implications for local taxpayers, the strength of the covenant for participating employers, the risk of their default and longevity risk.</li> </ul>	<p>Following each triennial valuation, the ISC re-assess the investment strategy in light of the updated information on the structure of liabilities. Asset / Liability studies have been used in the past.</p> <p>Whilst it is accepted that investment underperformance due to certain market conditions can occur, the ISC measures active managers against longer term benchmark outperformance targets.</p> <p>The strength of covenant of participating employers is considered in the formulation of the FSS.</p> <p>The admission of new employers into the Fund is not granted unless appropriate guarantees are put in place.</p> <p>Investment risks are highlighted within the ISS. A register of risks of not achieving each of the Funds objectives is maintained and reviewed on a quarterly basis.</p>	<p>The ISC is scheduled to consider an asset liability study based on the outcomes of the 2016 Valuation, in early 2017.</p>

Description of Principle	Essex Pension Fund's position	Future actions
<p><b>4. Performance assessment</b></p> <p>Arrangements should be in place for the formal measurement of investments, fund managers and advisers</p> <p>Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision making body and report on this to scheme Members.</p>	<p>The performance of the Fund and fund managers is monitored each quarter by the ISC, and all fund managers are held to account through meetings with the ISC and/or the Fund's officers and advisers.</p> <p>Performance data is provided by a specialist provider, independent from the fund managers.</p> <p>The Fund's contracts with its advisers are market tested when appropriate.</p> <p>The most recent effectiveness review of both the Strategy Board and ISC was undertaken in March 2017. The outcome of this review was reported back to the Strategy Board at their 8 March 2017 meeting. This included an assessment of both the Strategy Board &amp; ISC's effectiveness and that of the support received from Fund officers and advisers.</p> <p>Strategy Board &amp; ISC attendance and training outcomes are measured in the quarterly scorecard.</p>	<p>.</p> <p>. A further effectiveness review is scheduled for 2017/18.</p>

Description of Principle	Essex Pension Fund's position	Future actions
<p><b>5. Responsible ownership</b></p> <p>Administering authorities should:</p> <p>Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.</p> <p>Include a statement of the authority's policy on responsible ownership in the Statement of Investment Principles.</p> <p>Report periodically to members on the discharge of such responsibilities.</p>	<p>The Institutional Shareholders' Committee Statement of Principles has been superseded by the Financial Reporting Council's (FRC) UK Stewardship Code and it is now the standard for the investment management industry</p> <p>The Fund's Investment Strategy Statement includes the following:</p> <p><i>"The Fund fully supports the UK Stewardship Code and requires those of its investment managers who hold shares on its behalf to comply with it or to provide the ISC with an explanation of why it is not appropriate to do so, in the exercise of the mandate that they have been given, and how they will instead achieve and demonstrate the same level of responsible share ownership."</i></p> <p>Investment Manager reports circulated to ISC Members include details of voting records.</p>	

Description of Principle	Essex Pension Fund's position	Future actions
<p><b>6. Transparency &amp; reporting</b></p> <p>Administering authorities should:</p> <p>Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives;</p> <p>and</p> <p>Provide regular communication to members in the form they consider most appropriate.</p>	<p>Each quarterly meeting of the Board includes a review of the Fund's business plan and risk register. Furthermore a detailed scorecard is used to monitor progress against the stated objectives. Agenda papers are published on the internet and the meetings are open to the public.</p> <p>An Employers' Forum is held every year and includes presentations from the Board Chairman, Fund officers and advisers as well as the opportunity for questions to be raised.</p> <p>The Fund's web site is <a href="http://www.essexpensionfund.co.uk">www.essexpensionfund.co.uk</a> and includes the:</p> <ul style="list-style-type: none"> <li>• Annual Report and Accounts</li> <li>• Funding Strategy Statement</li> <li>• Investment Strategy Statement</li> <li>• Governance Compliance Statement; and</li> <li>• Communications Policy</li> </ul> <p>Individual scheme members receive newsletter updates throughout the year in addition to annual benefit statements.</p>	

## Definition of Terms

ACCESS	A Collaboration of Central, Eastern and Southern Shires
AAF0106	Internal Control report undertaken by an external auditor
CIPFA	Chartered Institute of Public Finance and Accountancy
CPD	Continuing Professional Development
CPI	Consumer Price Index
ECC	Essex County Council, Administering Authority of Essex Pension Fund also known as Scheme Manager
ESG	Environmental, Social & Governance
EY	Ernst & Young
FRC	Financial Reporting Council
FSS	Funding Strategy Statement
FTSE	Financial Times Stock Exchange
GDP	Gross Domestic Product
IPD PFI	Pooled Property Fund Index
IRR	Internal Rate of Return
ISC	Investment Steering Committee
ISS	Investment Strategy Statement
LA	Local Authority
LGPS	Local Government Pension Scheme
LIBOR	London Inter-Bank Offer Rate
MiFiD II	Markets in Financial Instruments Directive
MSCI AC	Morgan Stanley Capital Index All Countries
MSCI EM	Morgan Stanley Capital Index Emerging Markets
OECD	Organisation for Economic Cooperation and Development
PAB	Essex Pension Fund Advisory Board
PSB	Essex Pension Fund Strategy Board
S151O	Section 151 Officer
SDLT	Stamp Duty Land Tax
SIP	Statement of Investment Principles