Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	**Lincolnshire Pensions Committee**
Date:	**17 March 2022**
Subject:	**Investment and Responsible Investment Beliefs**

Summary:

This paper summarises the discussions had at the training session held on 17 February to update the Committee's investment and responsible investment beliefs.

Recommendation(s):

That the Committee consider and agree the amendments to the Investment and Responsible Investment Beliefs.

Background

1. It is considered best practice to have considered and documented the investment beliefs of the Pensions Committee, and the responsible investment beliefs, and to review them at regular intervals. These are built into the investment strategy setting for the Fund and can be used to assist decision making. In addition, they can be used to ensure that new members on the Committee understand previous investment decisions taken. These are included within the Fund's Investment Strategy Statement.

2. The Pensions Committee first set their investment and responsible investment (RI) beliefs in 2019 and, following changes to Committee membership and as we approach the triennial valuation and strategy review, it was agreed that it would be useful to revisit these beliefs to ensure that they still reflected the Committee's views.

3. David Morton, the Fund's Investment Consultant from Hymans Robertson, facilitated a session with both the Committee and Board on 17 February 2022 to review the current beliefs. The output from that session is attached at appendix A, with proposals for amendments and clarifications for the Committee to consider, and actions and next steps that will be brought into future meetings and reports.

4. Set out below is the suggested version of amended Investment Beliefs and narrative, including the introduction that appears in the Investment Strategy Statement and the key changes highlighted in italic. Further detail is included in the full report in the appendix.

Investment Beliefs

These beliefs form the foundation of discussions, and assist decisions, regarding the structure of the Fund and the strategic asset allocation. In addition, they are used to ensure that new members on the Pensions Committee understand previous investment decisions taken. It is recognised that environmental, social and governance (ESG) issues are important to the long-term success of the Fund, and the Committee aims to integrate consideration of these issues into all aspects of the Fund's investment arrangements.

This includes what was the old belief 5 to ensure that ESG is overarching across the investment beliefs.

Belief 1: The Fund should take no more investment risk than is necessary to have a reasonable chance of achieving its objectives, and only where the Committee believes it will be rewarded over the longer term.

It is recognised that investment risk is needed in the Fund to generate the required returns, however this needs to be considered on an on-going basis to ensure it is appropriate (i.e. not too high or too low) given the Fund's objectives.

This is unchanged.

Belief 2: Funding, contribution requirements, and investment strategy are linked; as the funding position and contribution requirements change, the level of investment risk should be adjusted accordingly.

The Committee's aim is to strike a reasonable balance between 1) building up a pool of assets to meet members' benefits when they fall due, 2) maintaining contribution requirements at a reasonable and affordable level, and 3) minimising investment risk.

Consideration of contributions has been added to the belief and the narrative has been amended to reflect that.

Belief 3: Investing in illiquid assets provides opportunities for enhancing returns and investing in alternative asset classes helps to diversify the Fund structure.

The Committee accepts that by "locking away" funds for longer periods of time, the Fund should expect to be compensated for the lack of liquidity in the form of higher expected returns. However, it is understood that this is not suitable for all the assets in the Fund.

The Fund’s investments should be diversified by combining assets with different risk, return and liquidity characteristics, whilst maintaining realistic expectations about the potential for sources of return to become correlated under market stress.

The Committee believes an appropriate portion of the Fund should be invested in non-core asset classes, i.e. alternative assets, to provide diversification and reduce overall volatility of returns.

This is unchanged.

Belief 4: Passive and active management both have roles to play in the Fund's structure; passive to deliver low cost asset class exposure and active to add potential value, understanding that active managers' success should be measured over a reasonable timeframe.

The Committee believes that active managers can add a return premium over investment markets, over the longer term, but accept that this has a cost. Therefore, this is balanced with allocations to passive management to produce market returns at a very low cost.

This is unchanged.

Belief 5: Although fees and costs matter, it is the expected return net of all fees and costs that should be the Committee's focus, however it is important that the value provided by an investment is commensurate with its cost.

The cost of accessing different asset classes and different management styles must be understood to ensure that the Fund is obtaining value for money, however the expected net return is the most important consideration when assessing investment opportunities and monitoring investment performance. The Fund expects its managers to have signed up to the Cost Transparency Code, and it also participates in fee benchmarking to assess the fees being paid relative to other pension schemes.

Belief 5 has been removed and therefore belief 6 is renumbered. The amendment here is to add the concept of value.

5. Set out below is the suggested version of amended RI Beliefs and narrative, including the introduction that appears in the Investment Strategy Statement and the key changes highlighted in italic. There are fewer changes to the beliefs here, but more information in the report on actions and next steps suggesting changes that can be made to reporting, developing policies and strategy, which will be discussed at future meetings. Further detail is included in the full report in the appendix.

Responsible Investment beliefs

These beliefs form the foundation of discussions, and assist decisions, regarding the structure of the Fund and the strategic asset allocation. In addition, they are used to ensure that new members on the Pensions Committee understand previous investment decisions taken.

Belief 1: Companies with a responsible ESG policy are expected to outperform companies without an ESG policy over the longer term.

The Committee believes that companies that have well developed ESG policies will generally provide better long-term performance than those companies that have not considered ESG factors in their business.

This is unchanged.

Belief 2: The Committee considers that company engagement, rather than disinvestment, is the better approach to fulfilling their responsible investment objectives. However, should a company not respond to engagement, disinvestment should be considered. Disinvestment on a whole sector basis is not within the Committee's beliefs.

Disinvestment is a blunt tool that is not believed to provide the best outcomes over the medium to long term. The Fund will, through its managers and other organisations, engage with companies to bring change, but will consider company disinvestment if engagement fails.

While disinvestment on a whole sector basis is not considered appropriate, the Fund will not invest in companies whose products do not comply with the Geneva Convention.

This has been amended to change “could” to “should” on the consideration of disinvestment in companies not responding to engagement. In addition, the line in the narrative on companies not complying with the Geneva convention has been added.

Belief 3: Climate change and the expected transition to a low carbon economy is a long-term financial risk to Fund outcomes.

The Committee believes that climate change risk and the transition to a low carbon economy should be factored into asset allocation decisions and also investment decisions by managers to reduce the long term financial risk, but also to take advantage of the opportunities that may be available.

This is unchanged.

Belief 4: The Committee should focus on meeting its financial obligations to pay benefits to members.

Financial considerations should therefore carry more weight than non-financial considerations. The main objective of the Pension Fund is to ensure that it is able to pay benefits to its members as and when they fall due. Therefore, financial considerations will be at the forefront of any investment or asset allocation decisions.

This is unchanged.

Belief 5: The Fund's active investment managers should embed the consideration of ESG factors into their investment process and decision making.

The Committee believes that the consideration of ESG factors when making investment decisions should not be an add-on but should be embedded into the whole investment selection process. Any active managers appointed by the Fund will be expected to evidence this.

This is unchanged.

Belief 6: The Fund should collaborate with other investors if it could have a positive impact, and also engage with them and investment managers to better understand ESG risks.

The Committee believes that the Fund has a stronger voice when working with others, be it Border to Coast Pensions Partnership, Local Authority Pension Fund Forum (LAPFF) or any other organisations. The Fund will work with them and the investment managers to ensure that it understands the ESG risks and how best to address them. It is considered that the Pensions Committee represents the views of the Fund membership and, in addition, the views of the Local Pension Board are taken into account as part of their review of this document.

This is unchanged.

6. The Committee are asked to consider the updated beliefs that reflect the discussion at the training session and agree the final version to be included in the Investment Strategy Statement.

Conclusion

7. This paper sets out suggested wording to update the Fund’s Investment Strategy Statement and Investment and RI Beliefs, reflecting and summarising the discussion that was had at the training session on 17 February. Once the Committee have considered this, any agreed changes will be made, and it will be included within the Investment Strategy Statement and published.

Consultation

a) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the Head of Pensions.

Appendices

These are listed below and attached at the back of the report	
Appendix A	LPF Investment Beliefs

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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